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NAZI INFILTRATION IN IBERO-AMERICA

BY FERNANDO DE LOS RIOS

I

ANYONE who follows the cultural and political life of Ibero-America can observe the various states' awakening to national consciousness, a tendency that has been growing for some time. The national movement in these countries, initiated, as in Europe, in the field of literature and history, has for the last few years been acquiring an acute political character. In both literature and history the movement has been very successful. Probably the best fiction now being written in Spanish and Portuguese is coming from Venezuela and Colombia, from Argentina, Brazil and Uruguay. The historians of Mexico, Brazil, Chile and Argentina are daily enriching historical research with their splendid contributions.

The projection, however, of the past into the future, the conversion of each nation's cultural unity into a program of action—this task so necessary for political development, is not yet fulfilled. And at the very moment when it might progress there appears in the social, economic and cultural life of Ibero-America the interference of Germany, armed with those powerful and efficient techniques that are so characteristic.

The nationalistic movement in Germany, initiated in the second half of the eighteenth century, attained its climax in the second half of the nineteenth century during the political struggles of that time. The *élan vital* of that historical stream should be sought in the immanent spirit of romanticism. From Friedrich Karl von Moser, the first to use the expression "German national spirit," in 1765, to Schiller, writing in 1797 about "Germany's greatness," and Hegel, predicting in 1821 the rule of history by Germany,

there is a perfect continuity. The stream that joins those dates is as limpid and transparent as is the ideological bond of Hegel with Spengler and the days in which we are living. The faith that created the national state in the time of Friedrich Wilhelm IV was the same which impelled Bismarck and which is alive, very alive, at this momentous hour.

But the Germans, who began by distinguishing between cultural and territorial nations, have concluded by unifying the two. Though they started by asserting the cultural idea of a nation as rooted in language, literature and religion, and considered these the basis of every possible state, they have reversed the terms and attributed to the state the "spiritual and religious" mission of founding the nation, and developing its potential unity. The cultural and political ambitions of the national state, thus conceived, have never recognized geographical limits. This was emphasized by Hitler in his Reichstag speech of February 20, 1938, proclaiming a protectorate over German minorities abroad.

How can this attitude be reconciled with the efforts of the Ibero-American countries to create a national consciousness? In what measure are these countries conscious of the radical opposition between their own national ideals and those which prevail among German minorities, scattered throughout the lands between the Rio Grande and Patagonia?

II

Except in Brazil and Peru, where Japanese immigration is very important, Ibero-America has received its immigration mainly from Spain, Italy and Germany. Therefore Axis activities in these countries, if coordinated and directed, can become a political factor of unpredictable consequences. Such a result will be reinforced if a government of the tendencies represented by Laval is to prevail in France, which has enormous cultural prestige in Ibero-America. Among the immigrants a majority of the Italian colonists may be regarded as politically favorable to totalitarian action, but a big minority, mainly in Argentina, and the enormous majority of

the Spaniards, are resolutely opposed to such action. It is the Germans, however, that we are concerned with in the present discussion.

According to the best available data the total German population in Ibero-America is between 1,200,000 and 1,300,000. It is distributed very unequally, however, because there are two centers of concentration, Brazil and Argentina, the former with approximately 800,000 German-speaking inhabitants and the latter with about 250,000. Even in Brazil the German population is highly concentrated, two states accounting for three-fourths of the total. In that country the distribution of the German inhabitants among the various states is as follows: Rio Grande do Sul 400,000; Santa Catharina 200,000; Paraná 70,000; São Paulo 50,000; all others 75,000. A glance at the map of Brazil shows that the four states in which 725,000 Germans are settled are geographically continuous. This fact has made it easier for them to act in the internal national life of Brazil as an homogeneous unit, organizing by prior coordination every collective step and watching the activities of every individual who arouses suspicion.

In addition to the enormous colonies in Brazil and Argentina there are more than 40,000 Germans in Chile, at least 15,000 in Venezuela and 6,000 in Ecuador. There are relatively small settlements in Mexico and strong minorities, perfectly organized, in the other states.

In September 1938 the director of the "Germanic Union of Argentina" published in the *Berliner Tageblatt* the following figures, in reference to Argentina: persons of German or mixed German blood 236,725; German schools 203; German societies 301; Nazi organizations 102; members of the Argentine section of the Nazi party 43,626. The figures for Brazil, as given in a publication of the Reichsverlagsamt, are more general, but there are two which are impressive: German schools 2,010; German societies 2,299. Similar figures for other countries, also contained in the latter publication, are: Uruguay 5 schools and 34 societies; Bolivia 3 and 22, respectively; Paraguay 1 and 46; Venezuela 2 and 29;

Ecuador 3 and 6; Peru 2 and 19; and for Colombia 22 societies were reported in 1938.

It must be remembered that under the Nazi conception German "colonies" are treated as German settlements abroad, and regarded as subservient to the German state. This principle, so full of implications for the present and for the future, for internal public law as well as for international public law, is the guiding idea of the present German regime, and is already operating in Ibero-America in the same dramatic form in which it has acted in many countries of Europe, countries that are now either prostrated or subjugated.

The organization that the German state has given its "colonies" from Berlin is significantly illuminated by a passage in the 1939 *New International Year Book* (p. 43), referring to the consequences, as reported by the Prosecuting Attorney of Argentina, of the protest aroused by the fact that Germans living in Argentina had participated in the plebiscite on Austro-German union in April 1938. The attorney's report stated that the investigation had uncovered "extensive illicit and unconstitutional activities by the Nazis," showing that "all Nazi organizations in Argentina were headed by appointees of the German Nazi party and completely controlled from Berlin or Munich. The members were organized on a military basis. They made regular subscriptions to party funds in amounts dictated by their leaders, and were forbidden to use the Spanish language at their meetings or to become naturalized Argentine citizens. They wore Nazi uniforms, engaged in military drill, and excluded Argentine flags from their meeting halls." "German laborers in Argentina were obliged to join the German labor front," the report continued. "Anti-Nazi Germans were ostracized and black-listed. Nazi activities in all sections of the country displayed considerable disrespect for Argentina and the laws of the republic." This black picture coincides with the result of another police research, undertaken in Brazil as a consequence of the conspiracy against President Getulio Vargas, disclosed in May 1937, and with the reports made public by the Prosecuting

Attorney of Uruguay on September 22, 1940 (published in the *New York Times* of the following day).

Such reports recall the speech of Goering at the Congress of Stuttgart, September 1938, before the Nazi representatives of the Germans scattered all over the world. He said to the 10,000 delegates: "Each one of you is my personal agent, and I want to know the commercial conditions of the countries in which you live, their needs and their competences." And Goebbels: "The members of the party abroad are the ferment of Germanism in the world."

Thus the traditional ideas of emigration have been entirely upset by Germany. Emigration from that country is not free but is organized, directed and planned in accordance with political aims. Every emigrant is if necessary an instrument of the state, located where the strategical conveniences require.

At the top of the hierarchical structure of all German "colonies" is the office in Germany which administers Germans living abroad. This office has two functional supervisors in each country or group of countries; under them are the leaders of Hitler youth and the leaders of the Labor Front. The former have under their supervision the German schools and the sport and cultural clubs for youth. The leaders of the Labor Front supervise the German workers and businessmen and their clubs. From among all of these various organizations are selected the members of the Nazi party section for each country, and a Gestapo chief with a general mission is set at the top of the entire organization. Each province or district is under a *Gauleiter*, and a smaller territory, or "point of support," is under a *Stützpunktleiter*.

It is to be assumed that the political behavior of the leaders is coordinated by some supreme authority in the region where they are operating. Is this function assigned to the consuls, as has been asserted by the Prosecuting Attorney of Uruguay? Is it ascribed to legations or embassies? We do not know, but if Germany considers these "colonies" as a projection of herself, at least with regard to their political status, there is no reason to believe that consuls, ministers and ambassadors are denied the political function of

leadership in foreign countries. It should not be forgotten that the Nazi state is a racial state, and that therefore it does not regard the juridical borders of its sovereignty as coinciding with geographical frontiers. The state is present, acting and exerting political influence, wherever there is a single voice that can speak on behalf of the mystical Germanic blood. Obviously this thesis means the dissolution of the principle of internal sovereignty of the state. It explains the conditions revealed by the Prosecuting Attorneys of Argentina and Uruguay in their reports.

The functions of the German "colonies" in every country of Ibero-America may be summarized as follows: first, they are advance guards, called upon to spread the new gospel, the new ideal; second, they must keep in touch with and support the local authoritarian groups, especially the "national" party; third, they serve as instruments for the sale and consumption of German products; fourth, they are organs of infiltration, vigilance and information; fifth, they constitute the point of support when the decisive hour, the military hour, arrives.

Since the "colonies" are connected with every branch of economic life, every directing organ of cultural activity and every political party, the orders or mandates that are received find thousands of previously prepared mouthpieces. Through *Trans-Ocean*, a German news agency, hundreds and hundreds of newspapers, either bought, subsidized or helped by lavish advertising, receive elaborate and subtle information almost gratuitously. Short-wave radios spread all over the continent the doctrine of Nazism and present the prescribed version of news events. German companies—the "Condor Syndicate," the "Lloyd Aero-Boliviano," the "Sedta" and the "Scadta"—have for many years operated airlines not only as passenger routes but sometimes, as in the case of the last, with the function of obtaining an agrarian map that makes it possible to study in detail the zone bordering the Panama Canal. Supplementary to these instrumentalities are the German industrial and financial enterprises, which, though apparently of a private character, are really controlled by the state. In Argentina,

Uruguay, Brazil, Chile and Peru political penetration is backed by a strong economic organization; in Mexico, Colombia, Ecuador and Central America activity is predominantly of a political character, but with an economic as well as a political goal.

From Mexico to Argentina the *mot d'ordre* in German international policy is attack against the United States and England, which are the scapegoats chosen to explain all the misfortune suffered by the Ibero-Americans.¹ The attack is carried on, first, by emphasizing the investment of these countries, demonstrating, as is obvious, that by far the greatest proportion of the foreign capital in Ibero-America—about 83 per cent, according to German figures—represents investments of the United States and England. Second, the allocation of the investment is made an object of suspicion, with an attempt to prove that the purposes of this financial and economic colonization are political and strategical. The third point is the conclusion, implied in the sarcastic emphasis with which both the "Fuehrer" and the "Duce" use daily the expression "plutocratic democracies" as a symbol of an exploiting world that is dying, making way for a new order with a new polar star.

This action of propaganda is of such magnitude that it is very difficult to comprehend it without a certain knowledge of German efficiency in the art of coordination, and an understanding of the malleability of the "new Germans" when the magic words of their leader are invoked. Concerning the power of this magical appeal it can be said—as Frazer has said about the totem—that the ties it creates are stronger than the ties of blood and family. We may well remember those profound words, written by Montesquieu:

¹ The political trend of the present campaign of Nazism in Ibero-America can be discerned in newspapers published in Mexico City—*Deutsche Zeitung von Mexico* (Edición en Español, Sociedad Anónima) and *Diario Alemán* (edited by Teodoro Schumacher)—in the booklet, widely distributed without charge, *El espíritu a través de los infortunios de Mexico* (Chantecler, Mexico, 1940) and in the editorials of *Timon*, the weekly newspaper that disappeared last June. In Costa Rica has been published an anonymous leaflet not only warning the people against the ambitions of the United States in regard to Ibero-America, but also hinting that these countries may expect from Germany the same fate as befell the nations of Europe if they do not remain neutral in the present struggle (see the newspaper *La Prensa*, New York, October 10, 1940).

"Every nation has a great spring that moves her to act: Germany, obedience; England, liberty; France, the honor of her king." Obedience! This term, so laden with religious and moral tradition, appears now in a satanic guise, offering us a new lesson on the equivocal destiny of words.

III

Both Nazism and Fascism have thought of Ibero-America as the promised land. "It will indeed be a blessed day for the inhabitants of South America when they pass from the effects of their Hispano-Portuguese heredity to German rule," says Tannenberg in *Gross-Deutschland*. In January 1938 the *Corriere diplomatico e consolare de Roma* declared: "Seven republics of Latin America are already decisively favorable to its stabilization, as a result of the adoption of principles founded by Mussolini. They are Argentina, Brazil, Uruguay, Bolivia, Paraguay, Peru and Venezuela." The statement adds that the republics of Central America, with the exception of Costa Rica, also follow the "triumphal light of fascism." I shall resist any temptation to indulge in judgment on these statements. I do not dare to put at the end of such claims either an assent or a negation, still less a smile of contempt for their arrogant suggestion of what may come. For I am convinced that anything can happen in these countries.

This unpredictability rests on many factors. In the first place, all these countries, and some not mentioned, are operating under an authoritarian system in which the army plays an important political role, either dominating political life directly or serving as a pliable instrument of control. There is not a single one of these countries in which representative constitutional institutions are functioning in normal form.² Even in Argentina and Uruguay, which are coun-

² The situation may be illustrated by the following summary of leaders and political conditions in these nations. *Argentina*—General Justo, ex-president; Dr. Ortiz, incumbent president. Recently a very delicate political situation; the representative government collapsed in 1930 and has not yet been completely restored. *Brazil*—Dr. Getulio Vargas, by a coup d'état, took power in 1932 and retained it in 1939 while changing the constitution; the army is his main instrument. *Uruguay*—General Alfredo Baldomir, president; under him the constitution is declining. *Bolivia*—since

tries of particularly responsible civil traditions, the moment is politically very confused.

A second factor in the vulnerability of Ibero-America is the existence of many psychological and geographical points of friction—between Panama and Colombia, Colombia and Ecuador, Ecuador and Peru, Peru and Chile, Chile and Argentina, Argentina and Brazil (through Uruguay, Paraguay and Bolivia) and between Guatemala and Mexico. The suspicions which are always alive in these points of friction—latent in some, extremely active in others—are now carefully and artfully being exploited by the Nazi and Fascist minorities. The border quarrels are a consequence of the past history of the Spanish countries, with their former division into four vice-royalties dominated by colonial governors, followed by a split into nineteen sovereign states.

The survival of a seignorial agrarian economy in Ibero-America is another factor making for uncertainty in regard to future developments. These are agrarian countries, without a middle class, and the large landowners have retained a seignorial conception of position and power. This again, like the influence of the army in civil administration, means a proclivity toward authoritarian attitudes.

1936 the constitution has been suppressed; the actual president is General Enrique Peñaranda. *Paraguay*—General Jose Felix Estigarribia, former president, suspended the constitution and assumed dictatorial power; his provisional successor is continuing in the same way, having placed the entire apparatus of the state under the control of the army. *Peru*—General Benavides, ex-president; through a coup d'état in 1936 he prolonged his mandate and in 1939 he made it possible for Dr. Manuel Prado to become president, in defiance of the elections of that year. *Venezuela*—General Eleazar Lopez Contreras, president; the country is now enjoying a more breathable atmosphere, although it is hard to consider the regime fully constitutional; as a result of an elaborate plebiscite in June 1935 the president will retain power until 1943. As for Central America, in *Guatemala* the president is General Jorge Ubico. In *Honduras* Dr. Tiburcio Carias Andino has been in power since 1933, and political liberties are greatly limited. In *Nicaragua* the constitution was changed in 1939 and General Anastasio Somora, president at that time, was reelected for an eight-year term; this government has a very personal character. Finally, in the republic of *El Salvador* General Maximiliano Martinez has ruled since December 1931, despite many incidents, having been reelected in 1939, if the term reelected can be used in this case, for a six-year term.

In most, though not in all, of Spanish America the tendency toward authoritarianism is widespread also among the Catholics. The attitude of the Spanish church has played an important role in favoring that tendency. On October 12, 1934, Cardinal Goma, primate of the Spanish church in Buenos Aires, urged the South American countries to turn toward Spain and away from the threats of "Monroeism, statism, Protestantism, socialism and simple mercantilism." He deplored the separation of the colonies from Spain, which he attributed to "the itching to try new democratic forms of government." He declared that democracy was dying and was unable to serve as a basis for *Hispanidad* and mold the people of the race into "a great unity for defense and conquest."³ This attitude of the church, obedient to a vast historical development, is capable of enormous consequences: the division of Catholic elements all over the world before the totalitarian principle. Maritain has recently emphasized this development, so visible in France, with words full of deep sadness.

Still another factor, and a particularly important one, in the vulnerability of Ibero-American countries is the mixed nature of their populations, which include masses of Indians and mestizos. On this a few figures are revealing: in Mexico Indians and mestizos constitute 90 per cent of the population; in Guatemala and in Salvador Indians constitute 95 per cent; in Brazil Indians and Negroes 59 per cent; in Peru Indians 85 per cent; in Venezuela Indians 62 per cent and Negroes 35 per cent; and in Bolivia Indians 87 per cent. It is only in Argentina, Uruguay and Costa Rica that this specific question does not exist, and I think that the lack of native elements is one of the factors that, directly or indirectly, pushes Argentina toward the leadership of Spanish America.

In most of the countries of Ibero-America the exploitation of the Indians is as great as or greater than it was a century and a half ago. They are neither politically nor economically organized. It is true that some countries—Colombia, Chile and Mexico—are ready

³ Cited by H. Rutledge Southworth, "The Spanish Phalanx and Latin America" in *Foreign Affairs* (October 1939).

to incorporate the Indians into active political life, are ready to work for them and with them; and some others, such as Peru, have begun to work for them but not with them. Many countries, however—Guatemala and Bolivia may be mentioned as examples—work neither for them nor with them.

This ethnographic factor is so important that it is worth while to dwell briefly on the role it plays at the present time in the internal political life of the people, and thus in the techniques of foreign penetration. I shall not touch on the question of the possible contacts of the Japanese with the Indians all along the Pacific coast, but shall speak only about the activities of the Germans. There is no country in Ibero-America where the problem of nationalism, as complicated by the ethnographic factor and the political interference of Germany, can be more fruitfully studied than in Mexico. But the subject is so full of questions and the Mexican reality so replete with contradictions that I cannot undertake a full discussion. I shall try to hold this problem within the proportional limits that it merits in a general picture.

The years 1910, 1917, 1920 and 1934 are decisive dates for all Mexicans living in this century. They represent the revolution, the *Querétaro* constitution, and the initiation of efforts, never wholly undertaken before, to raise the educational and living standards of the Indians. Whether the technical procedures were the most adequate may be questioned. The results of the social reforms may be discussed. But what cannot be brought into doubt are the emotional intentions of the reforms and the economic and cultural purposes of the reformers. The year 1910 symbolizes the beginning of the end of the agrarian seignorial period, even though the seignorial attitudes, stronger than the juridical apparatus that supported them, found refuge at times in industry, at times in the banks or in commercial or political life. The time between 1917 and 1934 was used by the Mexican leaders to organize the workers, and by the industrialists, businessmen and landowners to organize the defense of their own interests. These struggles have gone on, very angrily on both sides, to the present day. In Mexico

one breathes emotions of resentment, mutual, deep resentment, and with that disposition the national consciousness, very alert, very nationalistic, very Mexican, has been polarized in two positions. Historical factors, plus ethnographic factors, plus economic-social reforms, constitute the background of the political situation thus created.

If to these circumstances are added Mexico's constant suspicions of the United States, it will be easy to understand how excellent is the opportunity which the country's internal situation offers for the fulfilment of the mission entrusted to the German "colony": to intensify the struggle, to make impossible any sort of compromise between the political forces, if such a course can be advantageous to Germany's aims. In this respect the misfortune of Mexico in the present days cannot be overemphasized. Polemics have attained the most bitter tones, and the resultant excitement exposes the psychological flank to attack. I have the conviction that from within and without a situation has been prepared similar to that suffered by Spain. A lapse of twelve years has made it possible to compare the present attitude of the social groups in Mexico with that existing in 1928. At that time the religious problem was at its climax, but the strain was neither so widely extended nor so angrily manifested. Today the religious conflicts have been palliated with a sound sense of tolerance, but the political differences and the social struggles have become more acute than ever, although fortunately during recent weeks a movement of moderation has appeared.

I hope that the responsible elements of Mexico, one of the most intelligent countries of the Americas, will find a bisecting line, a basis of understanding, for the salvation of their splendid country. Mexico is potentially one of the most richly promising units of culture in this hemisphere. She has succeeded astonishingly well in assimilating Spanish culture to native forms, in achieving a powerful autochthonous impetus. But Mexico will not have an historical personality unless she can solve the Indian problem, and by cultural and economic means incorporate this enormous mass of people in active participation in civil life. All Mexico agrees on

this. All Mexico shares an exalted love of country, but the toxic of the present atmosphere has poisoned speech and spirit, and this transitory illness is carefully maintained on both sides—though with unequal vigor—by social elements which are pushing Mexico toward the abyss.

It is difficult to know how many Germans there are in Mexico, whether 5,000, 10,000 or 20,000, but the prodigious efficiency of the Germans makes it easy for them to be connected with every economic society, every cultural group, every military circle, to know everything and everybody in the country and to speak with the greatest competence about the most important matter or the most insignificant detail. Most of them know the language of the country when they arrive; otherwise they learn it in six or eight months. The contrast with the attitude and preparation of most Anglo-Saxons is astounding.

The Germans have received their preparation in Germany, in Spain and in South America. In Germany, besides the general classes in Spanish in the gymnasia, and the Romanic sections of the universities, there are the three Ibero-American institutes of Berlin, Hamburg, Cologne, and the "Weltwirtschaftliche Institut" of Kiel. Because of these institutes Germany is the one country in the world with centers in which to prepare specialists in Ibero-American problems—scholars, businessmen, diplomats—the one country in which the political and administrative institutions, the civil and commercial law, the economic and financial problems, of the twenty Ibero-American states are objects of learning and research. Moreover, Germany, many years ago, founded in Madrid, Barcelona and several other Spanish cities primary and secondary schools to which German businessmen, with a sound and practical sense, sent their sons for a knowledge of the original bases of Spanish culture. Finally, the Germans of today have developed centers of preparation even in countries of America, chosen carefully for this purpose.

There is, for instance, the case of Guatemala. For several years Guatemala has been enveloped in a certain veil of mystery and

silence. Many times we have heard the country spoken of as one of the centers of importation of arms and munitions from Germany, and recently we have seen the seriousness of Mexican suspicions about the role of Guatemala in connection with a possible insurrection in Mexico. Persons in the latter country are convinced that in such a situation Guatemala would act as Portugal acted toward republican Spain. It is believed that Guatemala is completely undermined by the Nazis, and that she contains in her territory elements eager to aid every force capable of changing the present direction of the political life of Mexico. Chiapas, the principal Mexican state bordering Guatemala, is the center of a German "colony."

One fact is unquestionable and highly suggestive. In Guatemala Germans have bought a great many farms, but those who hold and cultivate the land cannot be the owners, because they are replaced from time to time by others who are almost always new arrivals from Germany. Are these farms only centers of realistic training in tropical agriculture and in knowledge of language and habits? Or are they strategical points of concentration for political events? In any case the fact is puzzling—although the Mexicans consider it menacing rather than mysterious.

The case of Uruguay, on which recent events have concentrated international interest, is also very suggestive. Uruguay for many years enjoyed enormous prestige as a young democracy full of vigor and initiative. There was no better country in America in which to study the progress of public corporations and social legislation. A dynamic sense of civil life seemed to be the decisive feeling of the country. But the collapse of the constitutional democracy in 1933 opened the doors through which Fascism first and Nazism later but more strongly have found easy penetration into the country, at times even welcome.

IV

It would be a mistake to suppose—in line with the conception in vogue for many years and even at the present time—that Nazism

intends to use economic policy as the primary means of creating for itself a strong position in Ibero-America. Its economic ambitions, strong as they are, are now serving as an auxiliary weapon, subordinate to political action.⁴ The \$200,000,000 appropriated for propaganda, and the actions assigned to the German "colonies" by the central organs in Berlin, have been and I believe will continue to be the bases on which German penetration depends. But in spite of its fundamentally political character, even because of its political ambitions, Nazism desires and needs an economy congruent with its ruling aspirations. Thus its promising words of a new order of social justice relate also to economic relationships, and its activities in this direction are certainly not irrelevant to an understanding of some of its political success.

This aspect of Germany's penetration has been widely publicized, however, and one of its most important techniques is discussed elsewhere in the present issue of this magazine. Therefore in this review I shall avoid all details and shall present only a few salient facts.

For a brief summary of Germany's economic relations with these countries I quote the words of Benjamin H. Williams:⁵ "Since the establishment of the Hitler regime, German exports have shown a marked increase in Latin America. In a desperate effort to expand markets, the German government has aided exporters by various unconventional trade devices. The principal measures pursued by the Germans have been: 1) the system of 'Aski' marks, by which

⁴ For example, in 1937 two branches of the Siemens house, one of the most important firms of Germany, obtained a concession for the electrification of the Rio Negro, in Uruguay, with guarantees of public electricity plants and telephones. As a result of this contract the Nazis can for six years accumulate German technicians and workers in that strategic point, and build there a political and economic bridge between their colony in Brazil and that in Argentina. Speaking not so much of the present as of the future the menace is very serious. Also in southern Chile the political position of Nazism is very powerful, as a result of its control of the entire economy, agrarian, industrial and commercial. In Peru the sugar factory Gildemeister, has purchased a zone of land near Trujillo, the most important center of the country, and received from the former president the harbor of Chicana.

⁵ *Foreign Loan Policy of the United States Since 1933*, published by the Council of Foreign Relations (New York 1939).

goods sold to Germany are paid for by funds placed in account in German banks with the stipulation that they can be used only for goods purchased from Germany; 2) subsidies on exports from Germany through money raised by a levy on industry in Germany; 3) barter arrangements by which goods of one kind are exchanged for goods of another kind in accordance with agreed prices."⁶

As a sidelight on this enumeration of methods I may add a personal word. Last June, crossing by car the majestic lands of Michoacán, as guest of one of the high political and military personages of Mexico, I had the opportunity to hear what in the months since I have heard persistently from authorities, friends and pupils from Argentina, Chile and Colombia. Thus far, they say, not another country has shown that it has learned either the cultural or the commercial lesson implied in the behavior of Germany in America. They summarize Germany's commercial methods in the following way: first, Germany began by a study of the taste of the market, adapting her products to the idiosyncracies of national tastes; second, her customers receive import certificates in proper form; third, the goods received are exactly equal to the samples; fourth, the credits are almost always long-term; fifth, as a rule German

⁶ According to Otto E. Paul (*Südamerika* . . . , cited in bibliographical note at the end of this article) German imports from and exports to Ibero-America (in millions of marks) have increased as follows:

GERMAN IMPORTS				
	1933	1934	1935	1936
From South America.....	86.5	96.5	132.6	123.3
From Central America and Mexico.....	87.2	86.9	86.7	109.2
GERMAN EXPORTS				
	1933	1934	1935	1936
To South America.....	126.2	116.5	140.0	213.3
To Central America and Mexico.....	101.8	97.0	149.7	229.7

In 1936, according to the same source, Germany's trade with Mexico, Central and South America represented 31.8 per cent of her total transoceanic imports and 36 per cent of her exports. Williams (*op. cit.*) mentions that the German share of Latin American imports rose from 11.5 per cent in 1932 to 15.3 per cent in 1937; as the most suggestive example of German expansion he offers the record of Germany in Brazil: her exports to Brazil mounted from 12.1 per cent of that country's total imports in 1933 to 23.9 per cent in 1937 and 24.8 per cent in the first nine months of 1938. During the same period United States exports to Brazil remained almost stationary, at around 23 per cent.

goods are cheaper and delivery is more expeditious. Taking account of all these factors, of the lack of markets in the United States for Argentine and Mexican goods, and of these countries' need for machinery, the barter system is regarded as advantageous.

A special word is needed in regard to Argentina and Mexico. Argentina is by far the most vital and the best equipped of the Ibero-American nations, and the one with the highest cultural level. With hardly 13,000,000 inhabitants she has a volume of foreign commerce which, in 1936-37, represented 37.6 per cent of the total of South America. This, according to Dr. Paul (*op. cit.*, p. 80) means a proportion of 170 marks per capita, as contrasted with 30 in Brazil. The six national universities of Argentina (the sixth opened in Mendoza in March 1939) are among the best in South America; Brazil has only four such universities. Argentina's budget for education in 1940 is superior to the total educational appropriations of the nine other republics of South America. And as a fact supplementary to these it may be mentioned that in 1938 Germany took 11.5 per cent of the Argentine exports as compared with 8.1 per cent taken by the United States. In regard to Mexico many factors could be stressed which have been emphasized in reference to Argentina. Mexico, the country of artistic genius in Ibero-America, impassioned, tragic by temperament, is engaged in a vast program of social and cultural reform. The love for the Indians is the result of an autochthonous national consciousness, widening and deepening every day. Mexico and Argentina are without doubt the leading countries of Hispano-America. Without an economic, political and cultural understanding with both, any hopes for a continental policy are grounded on quicksand.

v

Such is the general picture that should be envisaged. Such is the nature of the apparatus through which Germany is acting in Ibero-America, with coordination, vigor and efficiency, and with a faith that is now extraordinary. For in this hour of skepticism and individual selfishness, Germany believes. She believes in herself. She

believes in her ideal. She believes in the necessity for sacrifice, and she feels herself entitled to carry out a rejuvenation of history.

Does Ibero-America feel itself menaced by the possible consequences of the attitude of Germany? Does it regard as a danger the magnetic attraction that it represents for Germany? How has it reacted to what has happened in Europe to the countries that have had the unforgivable boldness to pretend to be masters of their destinies?

Any answer should distinguish first between government and public opinion, and second between genuine sympathy for the Nazi ideology and mere deference to Germany at this momentous hour. With the exceptions of Colombia, Costa Rica, Cuba, Santo Domingo, Chile and Mexico, all the governments of Ibero-America have been either frankly or shamefacedly sympathetic to Nazism. In Argentina, Uruguay and Peru powerful political parties—which in the first two have ruled for some time—counteract the forces sympathetic to Nazism. With some possible exceptions there are strong Nazi parties in all the Iberian states, recruiting their members mainly among the upper classes. But among these elements, as well as among the liberals and democrats, a nationalist feeling has emerged during the last decade and has now become a center of convergence. The various elements, starting from opposite points of view, are beginning to discover how love of country is, and should be, a primary and vital point of departure in every political venture. For this reason the Nazis, in so far as they are links with Germany, are declining. And for this reason the Spanish “phalangists,” making claims of “leadership” and “spiritual dominion” of Hispano-America, have not found the propitious climate that they expected.

Consequently from Argentina to Mexico and, what is more representative, from Brazil to Uruguay, a program of legislation against the Nazis has been initiated. In Brazil this policy was originated in 1937 and accentuated in 1938 through the dissolution of the Integralista party—the Fascist national party—which had been so close to President Vargas some months before. This development

reached its climax when the state took control of the educational institutions founded by the "colonies," and when, in August 1939, the government decided to break up the "homogeneous concentration of foreigners." With more or less intensity this way has been followed by most of the countries, and in some cases, as in Colombia, it has included suppression of the German airline. Generally speaking, the drama of Europe has produced a sharp reaction among many thinkers, political leaders and social forces of Ibero-America.

But this is not in itself a positive action. Where is the new faith? Where is the ideal capable of mobilizing the souls of these countries? How is the horizon to be illuminated with new hopes, possible hopes, human hopes? A charismatic feeling pushes Germany. How is it to be counteracted without a religious-social feeling able to light a collective ideal?

Never since the days preceding their independence has there existed for the Ibero-American countries so dangerous a situation. They are young countries in the process of internal nationalization. Their national consciousness is growing, but its roots have not yet extended or deepened as they must in order to absorb the potential sap of the national soil. The present moment is one that should mean international solidarity, and they have their minds full of themselves. It is a moment that requires maturity, and they often let themselves be drawn into quarrels of a childish character. In view of the central problem of today, the problem involved in the Nazi attitudes and methods, it is a vital question which direction will prevail in the countries of Ibero-America.

Europe has not succeeded in constituting itself a political unity. In order to do this, voluntary adherence to that idea would have been essential. Now Europe is plunged into the maelstrom. It is attempted to create a unified Europe, but one unified by force and subjugation, by means that suppress precisely what was the cultural essence of Europe: liberty of mind, liberty of thought, respect for the privacy of the individual and for the organic character of the collectivity.

Looking instead toward America I ask myself whether this continent will be able to succeed in the task of finding a new way of international life. Will America, a young continent, be able to work out a means of coordinating into a superior unity the plurality of nations within its borders? Will the nations of Ibero-America abandon the "master" idea of Mediterranean culture, Greco-Christian culture, the idea of the substantive value of individuality? Will they abandon the idea and ideal of a national personality? I hope not, because that would mean to die before being born. Or will they prove to have the fertile genius and creative capacity that are needed in order to promote some sort of confederation? I hope so, for these countries are splendid historical promises.

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THE FUTURE OF TOTALITARIAN BARTER TRADE¹

BY HANS STAUDINGER

IN RECENT years the totalitarian barter system² has reached such proportions that it may well be pondered whether world trade relations as we have known them are likely to be undermined and transformed by it. Such a situation would be accompanied by epochal changes. World trade would no longer be handled by private enterprise within a network of trade agreements, on the basis of most-favored-nation clauses which accord equal treatment to all foreign sellers and buyers, but would be channelized under a system of continually shifting preferences, perhaps administered by government monopolies even if carried on through private agencies. The exchange of goods and services would be determined not by comparative costs, as it has been determined within the network of multilateral trade agreements, but by the specific bargaining positions of the bilateral partners—as creditors, as monopolistic consumers. And the political power position of the stronger partner would tip the scale that weighed the values of the exchange rates. Such a change in world trade, caused by clearing procedures and specific qualitative as well as quantitative import regulations, would wholly shift the directions of trade.

But these effects of a continued and expanded barter trade, serious as they might be with regard to the structure of world production and the national income of various nations, are overshadowed by the dangers that the barter trade system might lead to further political conquest by economic means. The barter sys-

¹ This article has been prepared in connection with the Peace Research Project of the Graduate Faculty.

² In its broader sense barter trade means that not only imports, but also trade balances and other foreign claims, are settled through bilateral, possibly even multilateral, arrangements, with exports of goods or services, instead of in internationally recognized currency or gold.

tem can adjust the direction of production in the supply countries toward the needs of the powerful customer, thus making the former dependent upon the market of the latter. As a result, not only the economic interests but ultimately even the domestic policy of the weaker nations might come under the influence or even the control of the powerful bargaining partner.

These are fundamental problems with regard to the future political and economic structure of the world. Will the totalitarian system, if it survives the war, succeed in remolding the economic and political structures of the main agricultural and raw material countries in accordance with the demands of its own industrial centers? An answer can scarcely be attempted as yet with regard to the European countries which have already fallen into the clutch of the barter trade system; for them the future is wholly dependent on the political situation which will come in the wake of the war. But the question whether the barter trade system might reshape the Ibero-American countries into satellites of the totalitarian regimes—a question which vitally affects United States foreign trade and credit policy—is still an economic one and is capable of at least analysis.

In the current discussions of this question two strictly contrasting opinions are represented. One view is that if Germany is not wholly vanquished the barter trade system between Europe and the western hemisphere will very probably prevail and even expand after the present war, and that the only defense against its economic and political implications is the development of the highest efficiency in United States industry and trade, so that we may consume more goods at home and sell more goods abroad—and perhaps even develop national self-sufficiency. According to the other view barter trade of the German type can be pursued only under specific financial and economic conditions, and even in the past years the agricultural and raw material countries could have been relieved from the German bargaining pressure by a consistent and farsighted foreign trade policy on the part of the democratic nations.

For the solution of these controversial issues certain suggestions may be contributed by a brief review of the conditions under which the barter trade network of Germany was built up. In this survey I shall not attempt to discuss the various specific techniques that have been developed in the operation of the system.

The Barter System under the German Republic

The barter system was not a new invention of the National Socialists or a preconceived, planned aspect of their program. In fact, they did not at all realize in the beginning that barter trade, based on a refined and tightened exchange control, with its direct and indirect effects of restricting imports and channeling exports, could become one of their principal weapons for reducing hard-pressed agricultural and raw material countries to political and economic dependency—a weapon especially useful in regard to those countries which the “bible,” *Mein Kampf*, decreed to be part of the German living space and sphere of influence.

The barter trade system was a consequence of the collapse of currencies which occurred in the great world depression. It developed from the system of exchange control, which had been necessitated by the shortsighted withdrawal and flight of capital from the debtor nations, and by these nations' lack of gold and free currencies. In its inception foreign exchange control was not intended as an instrument for shaping foreign trade policy. “The German government tried to use exchange control exclusively as a means for the protection of the currency and not as an instrument of trade policy.”³ Also the system of import control—with its crude setup of devisa quotas for imports, amounting first to 75 per cent of the 1930-31 average—was thought of more as a means of preventing the flight of capital into import goods than as a means of trade regulation. Reichsbank President Luther made it clear that the intention was not to curb imports, but that “by means of an automatic curtailment of imports we have tried to follow the shrinkage of the people's purchasing power. We were

³ C. H. Müller, *Grundriss der Devisenbewirtschaftung* (Berlin 1938) pp. 253 ff.

compelled to proceed in this way in order to prevent the arising of a hollow space within which capital flight could develop and overabundant stocks could be established."⁴ But exchange control, when combined with even such a crude control of imports, inevitably affected trade relations, since it disturbed the payment nexus and diminished the former flow of imports. A result was the development of barter techniques as one, often the only, way of liquidating claims and continuing trade.

Thus Germany entered into a clearing system with the south-eastern European debtor countries, a course which was initiated by Austria's proposals at a conference of representatives of the central banks of these countries in November 1931. This road was taken primarily in order to thaw out the frozen accounts of German exporters, as in the treaty with Hungary, but also in order that compensation deals might be arranged without the restrictions of the German import quotas. These clearing arrangements Germany entered into mainly with the weaker-currency countries and those with which her trade balance was unfavorable. The German government did not realize, in pursuing such a path because of considerations of credit, that it had actually set out on the road to a new trade policy.

To these agricultural countries barter trade became a means of liquidating stocks which could not find consumers either in the foreign or in the domestic market. "When the collapse of currencies renders free choice impossible, it will be more profitable to trade goods with a clearing partner than to renounce both export and the coverage of import needs."⁵

Germany too had to maintain her export position, especially

⁴ Vollmar Flessner, *Der Aussenhandel im neuen Deutschland, Ziele und Wege der nationalsozialistischen Aussenhandelspolitik*, vol. 54 of the *Nationalsozialistische Bibliothek* (Munich 1935) p. 37.

⁵ Mark Mitnitzky, "Germany's Trade Monopoly in Eastern Europe" in *Social Research*, vol. 6, no. 1 (February 1939) p. 30. Mitnitzky does not overlook the fact that the temporary merits of this barter trade system are offset by its disadvantages "when either economic or political conditions are of such a nature that all the burdens of the new artificial change of direction fall on only one of the two partners in the trade."

with the stronger-currency countries which had not established exchange control and were in many cases restless creditors. To this end she hastened to conclude payment agreements with these countries, particularly those with regard to which her trade balance was favorable and from which she therefore feared reprisals. The payment agreements contained provisions for the maintenance of a stable ratio between Germany's imports from and exports to these countries, and since her trade balances with them were favorable she was able not only to make payments on their frozen accounts but also to secure for herself a certain amount of free *devisen*. As a concession to some of these countries Germany agreed to raise the quota of *devisen* for imports from them.⁶

In order to promote her exports Germany also developed practices, by-products of exchange control, which proved highly damaging to her hitherto carefully guarded debtor reputation. Exchange control froze mark accounts held by foreigners in Germany, but immediately after the system was inaugurated the German exchange control offices permitted use to be made of such accounts, within certain limits, for payments on German exports. The creditors, interested in liquidating their accounts and in receiving quick payment, were willing to accept a discount, which enabled German exporters to sell at competitive prices and thus to export more than would have been possible otherwise. This amounted, in effect, to a devaluation of the mark—a devaluation of which the German people were not aware—and it acted as a weapon for meeting the competition of countries with officially devaluated currencies. The various blocked marks were nothing but export subsidies at the expense of foreign creditors.⁷ The procedures regarding them also contributed to reducing the German debt, and at a cost of foreign exchange far below the actual amount of the debt reduction.

⁶ W. Fischer, *Devisen clearing*, vol. 5 of the *Schriftenreihe zum Devisenarchiv* (Berlin 1938) pp. 19 ff.

⁷ Hitler Germany based the various *Aski* marks on a similar principle. These were freely traded in abroad, mainly in Ibero-American countries.

Thus the methods of the barter trade system were already in use under the German republic. Germany induced the foreign exporters to finance her imports by buying in Germany, and she compelled her creditors to subsidize additional exports in order to be paid.

But in spite of these new techniques of clearings, payment agreements and compensation trade Germany's trade position became more and more difficult. It began to be apparent that imports were tending to rise in relation to exports. This was a result of the overvaluation of the mark. Germany's price level was still too high and too rigid, in spite of her deflationary policy. Moreover, as a result of the rough method of controlling imports by setting quotas dependent on previous averages, the composition of imports was unfortunate. The increased imports included undesired goods and even finished wares which competed with German production⁸—and this in a period of the business cycle in which price relations in the world market between raw materials and manufactured goods were favorable for industrial countries, such as Germany.

After other countries, especially those of the sterling bloc, devalued their currencies the world market prices for industrial products tended to decline even further below the prices which Brüning's deflationary policy could enforce for the German domestic market. This meant increased dangers also for the export orientation of Germany's trade policy. Thus the previously favorable trade balance tended to become reversed, causing a situation which, since gold and foreign exchange were lacking,

⁸ "Most foreign countries which introduced exchange control took care from the outset to use this control as a means for the planning of their import policy, with regard to both the goods that were purchased and the countries from which they were bought. In particular, the imports of 'unnecessary' or 'not vital' commodities were often curbed. On the other hand, the general German allotments led, during the crisis, to exactly opposite effects, for during this time of declining purchasing power the consumption of unimportant goods was shrinking anyhow; the exchange restrictions affected primarily those goods which were important because the demand for them remained stable. The reason for this was that the curtailments were equally distributed among the specialized importers of the same commodity or of a group of similar commodities" (Flessner, *op. cit.*, p. 37).

could be solved only by the tightening and refining of import controls.

This meant a continuation of the barter system. Now, however, the necessity for it no longer rested primarily on exchange difficulties, but grew out of Germany's isolated high price level. This price structure was the result of Germany's failure to answer the devaluation of the pound with an even more drastic devaluation of the mark. Luther and the Brüning government refused devaluation, dominated by a fear of disquieting repercussions in relations with creditor nations and eager to secure for Germany a nominal reduction of debts and interest payments by maintaining the official value of the German mark. Instead of devaluing the government continued its traditional policy of begging leniency from foreign countries, not only with regard to concessions on the service and payment of foreign debts, but also with regard to the granting of military concessions. At home it pursued a deflationary policy, thus lengthening the depression and heightening domestic political tensions—results which could scarcely be modified by an inauguration of public spending. The price paid to Germany for her self-restraint—the foreign concessions in regard to increasing the standing German army—came too late to strengthen Brüning's already weak position from the attacks by the military and conservative circles.

Thus when viewed in retrospect, and from a purely economic point of view, Germany's refusal to allow a drastic devaluation of the mark and, instead, her continuance of barter methods—even this without the backing of efficient import restrictions—appears as the most inconsistent course which an export-oriented country could pursue. And it was still more inconsistent that Germany countenanced export-promoting devices which brought her into disrepute abroad.

The Totalitarian Barter Web

When Hitler came to power the devaluation of the dollar again gave rise to the question whether Germany should devalue and

seek new access to the world market. And again such a policy was decided against, this time mainly because of domestic political considerations. Devaluation of the currency would have endangered the stability of the price level and led to labor troubles, which the National Socialists at that time could not afford. This political argument cut off any serious economic consideration of devaluing the mark.

In domestic economic policy two main problems were overshadowing: protection of German agriculture; and increase of domestic production through the "Battle of Unemployment." The means chosen to meet these problems were an expansion of the public spending program and the initiation of many devices for expanding private production without increasing wages, all supported by an effective governmental price control.

But meanwhile German foreign trade continued to veer toward an impasse. As is evident from the accompanying table, in 1934 the large export surpluses of 1930 and 1931 turned into an import surplus which could not be met by reserves of gold or foreign exchange and claims for services. Consequently imports had to be sharply cut down. The official devisa quotas for imports were decreased from 50 per cent (of the 1930-31 average) in 1933 to 45 per cent in February 1934; in the latter year they declined rapidly to 35 per cent in April, 25 per cent in May, 10 per cent in June and 5 per cent in July. This reduction of imports and, still more, the composition of the imports already received, caused an increase of unemployment and endangered the whole Hitler program of expanding domestic production and beginning rearmament. (It is an irony of history that in this tense moment the repayment of the large Russian credits, the granting of which had been heatedly attacked by the National Socialists, brought a certain relief.)

As a result of this critical situation—which was a matter of the gravest concern to the high officials—the Hitler government inaugurated its extensive import and export control, based on a refined and continually revised priority system. It was economic

SELECTED DATA ON GERMAN TRADE, 1929-38

Item	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938*
Index of German industrial production ^b	100	88	72	58	65	82	95	106	116	124
German imports, in millions of marks ^c	13,447	10,393	6,727	4,667	4,204	4,451	4,159	4,218	5,468	5,449
" exports, " " " "	13,483	12,036	9,599	5,739	4,871	4,167	4,270	4,768	5,911	5,257
Index of total German trade value ^d	100	81.8	60.7	38.7	33.5	31.6	31.2	33.4	42.1	39.0
German trade value in % of world trade value ^e	9.5	9.8	9.9	9.5	9.1	9.0	8.7	8.5	8.7	9.2
Index of value of imports ^d	100	77.0	50.0	34.7	31.1	32.6	30.9	31.4	40.6	40.5
" " " exports ^d	100	89.2	71.2	42.3	36.0	30.8	31.7	35.4	43.8	39.0
" " price " imports ^d	100	87.0	66.6	49.6	45.3	45.6	46.7	49.2	54.4	52.1
" " " " exports ^d	100	94.1	82.5	71.6	64.7	62.0	59.0	60.0	64.0	67.1
" " terms of trade (export in % of import prices) ^d	100	108.2	123.8	144.4	142.8	135.9	126.6	122.0	117.6	128.8
% share of industrial countries in total German imports ^e	38.9	38.4	39.1	36.1	35.4	33.0	31.1	29.9	27.8	28.1
" " " non-industrial " " "	"	61.1	60.9	63.9	64.6	67.0	68.9	70.1	72.2	71.9
" " " industrial " " exports ^e	47.6	48.6	48.4	45.9	46.4	46.4	43.5	38.4	36.9	32.0
" " " non-industrial " " " "	"	52.4	51.6	54.1	53.6	53.6	56.5	61.6	63.1	68.0
" " " W. Eur. ^f " " imports ^e	22.5	22.1	23.2	20.6	20.9	20.7	20.3	18.4	17.7	16.9
" " " S. E. Eur. ^h " " " "	"	4.6	5.4	5.9	5.6	7.1	9.9	12.0	12.3	14.8
" " " W. Eur. ^f " " exports ⁱ	37.1	38.7	39.6	39.7	41.8	41.3	34.9	31.2	30.0	26.9
" " " S. E. Eur. ^h " " " "	5.1	4.6	4.3	4.4	4.1	5.6	7.5	9.5	11.5	13.2

calamity which brought about this development. At that time the National Socialists did not realize that this system was to give them the weapon for the exercise of the utmost political power over economic relations at home and abroad. By allocating raw materials and fixing prices they were able from then on to exercise control over every single enterprise and, what is more important, to shift production from the consumption goods industries to the heavy industries in favor of armaments. It was Schacht's "New Plan," established and refined during 1934 and 1935, which enabled Germany to restrict imports of consumption goods in favor of imports of raw materials.

As the National Socialists became aware of the power their policy gave them, a decisive change took place in Germany's attitude toward foreign trade, with the result that finally more than 80 per cent of her foreign trade was carried on through the various barter devices. From now on this system increasingly replaced the former normal world market trade, and with this changeover Germany shifted from an export orientation of her trade to an outspoken import orientation.

Thus it did not matter if the former export stimulus to wide branches of German industry slowed down. This happened be-

^a Germany's trade with Austria excluded from 1938 data.

^b From League of Nations, *Statistical Yearbook, 1938-39* (Geneva 1939) p. 186; index recalculated to 1929 base.

^c For 1929-37 from *Statistisches Jahrbuch für das Deutsche Reich* (Berlin 1935, 1938); for 1938 from League of Nations, *Statistical Yearbook* (cited above) p. 212, and *Review of World Trade, 1938* (Geneva 1939) pp. 32, 33.

^d From *Review of World Trade* (cited above) p. 74; indices recalculated to 1929 base.

^e For 1929-37 from *Vierteljahreshefte zur Wirtschaftsforschung, 1938-39*, vol. 3, p. 316; for 1938 from *Statistik des In- und Auslands, 1939-40*, vol. 1, p. 8.

^f United Kingdom, France, Belgium, Netherlands, Switzerland.

^g For 1929 from Report of Reichs-Kredit-Gesellschaft, Berlin, *Germany's Economic Situation, 1938-39* (January 6, 1939); for 1930-37 from *Statistisches Jahrbuch für das Deutsche Reich*, 1933 p. 220, 1935 p. 232, 1938 p. 282; for 1938 from Statistischen Reichsamt, Berlin, *Wirtschaft und Statistik*, no. 5 (1939) p. 177.

^h Hungary, Yugoslavia, Rumania, Bulgaria, Greece, Turkey.

ⁱ For 1929, 1934 and 1937 from *Germany's Economic Situation* (cited above); for 1930-33 and 1935-36 from *Statistisches Jahrbuch* (cited above); for 1938 from *Wirtschaft und Statistik* (cited above).

cause the expanding home market attracted the profit interest, and, even more, because the cumbersome and "atrocious" (*scheusslich*)—as Hjalmar Schacht called it—exchange and foreign trade control apparatus, with its graft and wasteful bureaucratic costs, worked as a deterrent upon foreign trading. Nor did it matter if the composition of exports was somewhat of a reflection of Germany's rearmament.

It was characteristic of the new import orientation that from now on German exports followed the channels of imports. It was not in correspondence with reality when the New Plan proclaimed the slogan: Buy from your customer and don't buy more than you can pay for. In truth another, undeclared principle was followed: Sell to your supplier! The accompanying table reveals how this import-oriented policy caused a shift of German trade away from the industrial countries to the suppliers of raw materials and foodstuffs. And it was certainly the intensified barter system, in which Germany used her strength as customer, which caused the conspicuous shift of her trade away from the countries of western Europe toward those of the southeast; this too is indicated in the table.

In all strategic problems the German barter trade system proved enormously flexible and ingenious, in spite of its highly bureaucratic administration. A former German official has disclosed that it was Schacht who carried through the exploitative and discriminative policy, which he personally detested, with regard to Germany's suppliers. In the fall of 1934, when Germany was actually devoid of foreign currency, Schacht succeeded in obtaining the necessary imports by paying for them on credit. These credits, which at times amounted to over a billion marks, were extracted from the weaker countries by reason of the considerable time lag between the delivery of imports of raw materials to Germany and the deliveries of German exports of finished goods to pay for these imports.

Germany made use of the peculiar conditions of the raw material and agricultural lands. Overproduction and depression had

weakened their bargaining position and made it difficult for them to sell their surplus on the world market, even at very low prices. For such countries it was therefore of the greatest importance to maintain and even expand their sales to such a great consumer as Germany. Otherwise prices for their products would have dropped still more. This fact made them ready to accept even the shackles of the barter system, especially since Germany offered them higher prices than those of the world market: Germany's exchange control isolated her domestic high price structure, and therefore she could well afford, within the barter trade system, to pay more than world market prices for her imports.

Because of these circumstances Germany's new relationship with these countries won the support of the agricultural majority of their populations, especially when the exportation to Germany caused rises also in domestic prices for the goods traded; in such cases it was mainly the urban minority that had to carry the burden. It is true that German exports, later on, were also high-priced (Germany certainly did not subsidize exports to the weaker countries). But in these agricultural countries industrial prices were high anyway, and therefore the new pressure of higher import prices did not make itself felt immediately.

Once entangled in the web of barter trade, these countries could not extricate themselves from dependence on the German market. First, they could not liquidate the balances in their trade accounts with Germany in order to buy perhaps more cheaply in other markets. Second, the existence of these accounts which still had not been transformed into imports from Germany compelled them to conclude new barter arrangements with Germany. Third, they considered it advantageous, in this depressed period for raw materials, to have a certain guarantee of sale through these barter arrangements, and thereby a guarantee for the continuation of production. Fourth, Germany frequently bought poorer grades which were less competitive, and often not even marketable, such as certain parts of the Brazilian and Turkish cotton crops, with the result that these countries were further bound to Germany

in regard to important sectors of their production. And beyond all these causes and effects Germany directly strove to increase the dependence of these countries by influencing them to adjust the nature of their crops to her own needs. Very early in trade treaties, and more so later on, spurred by the barter trade agreements, Germany induced them to shift their production away from such world-competitive products as wheat to products complementary to German production, such as oils, seeds, sunflowers, soya beans. This shift in production was accompanied by new, often German, investment for the processing of such products, which meant increased employment and thus increased dependence.

Statistics indicate that some countries which conducted extensive barter trade with Germany were able to improve their terms of trade. But even for these countries the trade statistics do not reveal the time lag between selling and buying, and certainly do not reveal whether the products bought in order to liquidate trade accounts were real necessities. (Some countries bought German-manufactured drugs in such volume that they would seem to be prepared for whatever headaches the future can bring.) In other countries, however, especially some of those in southeastern Europe, even the bald statistics indicate that the price lure of German purchases was a harmful influence, for it led eventually to a serious increase in the domestic price level. This was the sacrifice these countries had to make in return for the deals with Germany which enabled them to find buyers who assured them of a continued interest in their production.

For present purposes, however, a more important question is the effect of barter trade on Germany's own position. There is no doubt that Germany, too, often had to increase her domestic prices, especially because, when world market prices rose, her importers had to maintain the gap between them and the import prices established in barter trade. Official Germany was not concerned if the prices of foodstuffs and textile fibers were increased in this way. It was not even concerned if the poorer grades of cotton caused deterioration of the quality of German production

and, by distorting production, became a new cause of increasing prices, since this acted as a welcome throttle on consumption. Over-high prices for raw materials increased the prices for industrial products too, but this only helped to justify the government for developing *Ersatz* production in spite of its high costs. In short, the continual upward trend of prices, causing disproportionalities within the price structure, did not matter so much because demand was always ahead of supply, and because the upward trend was modified by the fact that government price control saw to it that price increases on foreign raw materials were at least partly absorbed by the manufacturers and middlemen.

It is considerably more significant that barter trade undoubtedly increased production costs in Germany, not only because delays and interruptions in the negotiations with foreign countries often halted the supply of necessary raw materials, but also because of the high levies exacted from industry in order to subsidize exports of goods with an elastic demand.⁹ In addition, the administrative machinery, private as well as public, was an enormous burden. We do not know the exact cost of the tremendous administrative apparatus supported by Germany at home and abroad, but even the National Socialist authorities admit the weight of this criticism.¹⁰ A British publication gives the following undoubtedly accurate account: "A certain deal involved the pur-

⁹ The most overt device of subsidy—the devaluation of the "outermark"—resulted from the creation of the industrial "self-help" fund, which, beginning in the middle of 1935, was raised by compulsory levies of 2 to 5 per cent on the annual turnover of all German business. These levies amounted to 800 million marks in 1935 and a billion marks in 1936.

¹⁰ "The criticism of exchange control finds particular ammunition in the different approaches to the matter and the bureaucracy which is a consequence. Three separate exchange laws since 1931, plus perhaps 50 separate decrees, amendments and orders, as well as the 500 circulars still in effect, represent a legal jungle and governmental structure of such variety and opacity that it is difficult even for the expert to make his way . . . Even the state offices were at first hopeful that exchange control would be a short-lived measure . . . Yet the course of events daily set new tasks and compelled the state to take the direction of foreign economy ever more directly into its hands" (C. H. Müller, *op. cit.*, introduction).

chase of 10,000 lbs. of wool against which German toys were exported. For this about 680 forms had to be filled in; and it was 18 months after the actual transaction before the bureaucratic formalities were completed. Of course this bureaucratic regime is felt least by the big companies with a considerable export surplus, such as the dye trust, or the general electrical concern. These are protected by the Reichsbank from the worst effects of official interference. The costs of economic control cannot be estimated. A confidential semi-official estimate of the direct costs of the machinery involved is 2,000 million marks per annum for wages, rent, stationery, etc."¹¹ These results are typical of the inorganic mixture of a rigid bureaucracy and private businessmen whose outlook and interest stem from another economic order.

To be sure, as is indicated in the table, Germany's export prices remained higher than her import prices.¹² Statistically she seems to have made a good bargain. But these figures should not be regarded as indicative of the results of the barter trade system as such, for throughout these years the odds in trading were in favor of the industrial countries. It is true that the German export prices for industrial products were higher than the English, for example, but from this advantage must be deducted the high administrative costs of the German system, its inner frictions and its costly subsidies.

Moreover, Germany's terms of trade, while favorable, steadily declined up to 1938. This decline not only indicates that the differential between industrial and raw material prices decreased, but also suggests that the barter trade countries felt a growing dislike of the German offers. Germany met such opposition with

¹¹ Germanicus, *Germany's Economic Position* (London 1937) p. 28. In the above figure the costs of currency control and of trade control are combined, but this is justifiable because the two types of cost serve the same purpose in an economy whose main characteristic is the development of home production for armament, with utter neglect of the possibilities of the world market.

¹² See also Howard S. Ellis' excellent description of the German terms of trade in "Exchange Control in Germany," *Quarterly Journal of Economics*, vol. 54, no. 4 (August 1940).

typical National Socialist opportunism, showing either lenient compliance or ruthless rejection, according to the strength of her own position. Thus in some instances she lowered the exchange rate of the mark for special goods and services, or lowered German export prices. In other instances, however, she broke off negotiations and shifted the channels of barter trade in regard to those goods for which there were trading difficulties.¹³

From a strictly economic point of view it may thus be seriously doubted that Germany actually gained from her system of barter trade; only to the extent that the system helped her to bridge a situation in which she was unable to buy commodities that were highly necessary was it an economic advantage. It served well enough as a temporary emergency device, but it is very doubtful whether, in economic terms, it would pay as a permanent method of trade. In other words, if Germany came into the possession of gold and foreign exchange, and did not continue her intensive armament, she would not find barter trade an economically advantageous exchange system.

There is no doubt, however, that Germany's financial and economic control methods vested in her an enormous political power at home and abroad. Her priority regulations enabled her to maintain a firm hold on German industry and, even more, on German entrepreneurs. The fact that the barter trade policy was linked to the National Socialist ideology was of great importance: first because the great party apparatus actively backed the system and prevented loopholes and evasions; and second, because the businessmen were more willing to endure the awkward procedure of the system when endurance was made a "national duty and virtue"—the magic formula for placating German citizens.

¹³ Germany's cotton import trade, for example, which had been shifted from the United States to South America, was again shifted, when Brazil raised certain objections, to Africa and Asia, with Germany always using the same devious pressure methods of importing at high prices but exporting at higher prices. In reference to cotton I highly recommend John Richard Huber's article on "The Effects of German Clearing Agreements and Import Restrictions on Cotton, 1934-1939" in *Southern Economic Journal*, vol. 6, no. 4 (April 1940).

Much more important is the political advantage which Germany gained abroad. After the barter procedures had succeeded in coordinating German economic interests with those of the agricultural and raw material countries the National Socialist leaders recognized the possibility of utilizing the support of certain interested groups in these countries for closer political connections. On the heels of the economic *Gleichschaltung* could follow a political *Gleichschaltung*.

An important technique in the achievement of political domination was the use of the enormous commercial bureaucracy, and even the official institutions abroad which had to deal with German business interests, for political propaganda; every German abroad was considered a political agent. This propaganda machine tried to show to the peasants, exporters and bankers the advantages of commercial relations with Germany because of her powerful position, thereby attempting to influence the domestic as well as the foreign policy of these countries.

And certainly Germany's political influence, once achieved, served in turn to strengthen her bargaining position when it began to be weakened by the increasing world demand for raw materials. The favorable price scissors between raw materials and industrial products had greatly helped German recovery and rearmament, and at the moment in which this scissors began to close, and thus enable Germany's suppliers to offer more resistance, the political prestige of Germany was high enough to balance the economic disadvantage. Perhaps this interaction of the political and economic elements in Germany's foreign trade position may help to explain why 1938, which was a year of world business recession, was also the year in which Germany could bring her influence to bear on southeastern Europe with such tremendous consequence.

Thus, in a word, the barter system is not in itself economically advantageous. But it grants political power to the stronger partner, and this power can be used to effect also an economic advantage. If Germany should survive the present war, and have gold and

foreign currency at her disposal, she would use the barter system as a means of exploiting the satellites within the orbit of her political power and as a tried and true weapon for further political conquest—a weapon much more effective overseas than bombing planes and submarines.

*Indications for the Future*¹⁴

It has been shown that the barter trade system developed as a pooling of emergency interests between overproducers and a large customer without gold or exchange reserves. If the pressure on the overproducers could have been alleviated, the lure of barter trade would have been ineffective. "Give the agricultural and mining countries any better alternative than the destruction of their surpluses and they will not be long in rejecting offers such as Germany's."¹⁵

There is no doubt that a different credit and trade policy of the great creditor nations, above all England, could have alleviated the weak bargaining position of the raw material countries. In looking backward at the political events of the thirties it seems incomprehensible that England and France failed to support economically the weaker countries which they backed politically. Economic support would have meant nothing less than strengthening the Allied defense line. Years ago England could have reversed Germany's favorable terms of trade in these raw material countries. She could have cheapened Germany's exports in terms of her imports "by competing for goods which Germany buys and offering to sell goods which she is selling."¹⁶ Germany's expanding war economy would have become vulnerable only

¹⁴ The problems involved in this section the late Fritz Lehmann discussed often and fervently with his colleagues and assistants. He contributed so much to their clarification that I cannot present my own views without acknowledging how greatly they have been shaped by these discussions.

¹⁵ Frank A. Southard, *Foreign Exchange Practice and Policy* (New York 1940) p. 197.

¹⁶ This belated recognition is made by T. Balogh in his extremely interesting article, "Foreign Exchange and Export Trade Policy" in *Economic Journal*, vol. 50 (March 1940) p. 15.

through a sufficient strengthening of the bargaining power of her raw material producers.

Here, indeed, lies the crux of the matter. Neither England nor the United States, each completely involved in her own domestic economic difficulties, was ready for international co-operation to fight depression. It was, for instance, a profound inconsistency in the trade policy of the United States to try to reestablish multilateral trade relations on an "equality principle," and not to create the economic and financial preconditions for the functioning of this system of international trade. Instead, the United States made tremendous efforts in her reciprocal trade negotiations to win back for her merchants markets which were deeply entangled in the German-dominated barter trade web. The result was bound to be disappointing to the United States and to help Germany indirectly to overcome certain tariff obstacles in countries with which both the United States and Germany had trade agreements. I repeat, the only road which would have led to the goal of reopening multilateral trade would have been the strengthening of the credit and trade position of these countries, so that they could achieve freedom of buying and selling in markets of their own choice.

But at the present time the dangers confronting the agricultural and raw material nations of the world are even greater than the threat of economic and political penetration through the barter system. Their production structures may be jeopardized still more seriously by the future development of Europe than they have been by the events of the past decade, for whatever the outcome of the war a prostrate Europe will be a very poor customer. It is true that for a certain time there will be a great European demand for food products, in order to compensate for the devastations of home production. But such a boom can be only temporary, only a transitional period while Europe revives her own agriculture. After that an impoverished Europe cannot for a long time resume its role as an important buyer of the surplus products of the agricultural and raw material centers of the

western hemisphere. It will be reduced to much lower standards of living—meaning less wheat, less meat, less tobacco, even less cotton, from foreign nations. If the Hitler regime is destroyed it is likely that extensive credits would be granted, but these would be used not for the products now exported from Ibero-America but for machinery, steel products and other goods needed for the restoration of productive capacity. And if the economic and political power of Germany should endure after the present war the whole production of Europe would tend to self-sufficiency oriented toward the needs of the industrial centers;¹⁷ exchange of goods, especially foodstuffs, with the Ibero-American countries would therefore be even more reduced, particularly since Germany would probably shift to Africa—presumably then within her political orbit—for whatever agricultural imports that would be essential.

Thus, whatever the outcome of the war, the problem that faces the western hemisphere is much greater than whether the coils of barter trade can be avoided: it is whether a way can be found to prevent the collapse of Ibero-American trade. Such an economic disaster would bring political disaster in its wake, and fascist regimes based primarily on domestic troubles might spring up even without the direct stimulation of Germany.

The defense of the western hemisphere therefore necessitates even more than strengthening the bargaining power of the Ibero-American nations. If conditions are to be avoided in the New World such as those that have led Europe to disaster, it is essential that competitive relationships with Ibero-America, especially those concerning agriculture, be turned into complementary, cooperative relationships. This would mean changes and adjust-

¹⁷ Fritz Lehmann proposed and undertook an investigation into the self-sufficiency in foodstuffs and raw materials of a united Europe, with due consideration of the various levels of production and income. This study was to inquire into the already prevalent de-Europeanization of world trade, and examine whether and under what conditions European autarchy would be possible. The work is being continued on the basis of Lehmann's proposals by his former assistant, Mr. Julius Perlstein. I am indebted to Mr. Perlstein and to Mr. A. Hosiosky for their extensive contributions of material for this essay.

ments in agricultural production, not only in the nations to the south but also in the United States. And it might mean a sacrifice, as does every defense measure, in this case a temporary sacrifice of agricultural production at home, until the home market could be developed for other less competitive agricultural products. As a "productive" defense measure it might be desirable to develop in the Ibero-American countries, even under temporary subsidies, the production of raw materials essential for warfare.

These are far-reaching measures. But these nations can be defended more easily through economic than through military measures, and in all dealings with Ibero-America not the immediately anticipated profit but the security of the western hemisphere should be decisive. The English were too hypocritical and too self-confident to recognize the dangerous political implications of the barter trade relations between Germany and the southeastern European countries. As a result, they recognized too late the importance of establishing a position of economic defense. The question now is whether the United States will learn from England's experience and combine military and diplomatic defense policy with economic defense measures.

It seems that American spokesmen are at least willing to recognize and to face unpleasant facts, but the mere recognizing of an unpleasant fact may be even more dangerous than blindness if recognition leads only to the conclusion that nothing can be done. Herbert Hoover, for instance, declared in his speech on "Post-War Economic Problems" at the bicentennial celebration held by the University of Pennsylvania on September 18, 1940: "The idea of the free States combining against the totalitarian nations in trade is just nonsense. The world has to live, and moreover the interests of the free States are too divergent to consummate any such a combination. For instance, our South American cousins cannot live unless they sell their agricultural surpluses into the totalitarian areas. They cannot sell their surpluses to us. We produce a surplus of many of the same com-

modities, and they will buy totalitarian manufactured goods in return. Any other expectation is a sheer illusion."¹⁸

It is a task of statesmen to transform "illusions" into workable solutions. In this regard it may be said that for England an intensive economic and financial engagement in southeastern Europe would have entailed great losses for some time to come. At the present time a United States investment in cooperation with South American countries, in sales and storage organization, would be very high but it would involve lower costs, even in the near future. The immediate postwar rise in demand for agricultural products, even if temporary and even if dependent on emergency credits extended to Europe, will offer an opportunity to use the combined bargaining strength of the Americas in setting prices and trade conditions—and this breathing spell would facilitate the task of adjusting production structures with regard to the diminished purchasing power of Europe.

After the war the United States will have an unprecedented opportunity to influence the foreign trade of Europe, however that continent may look on the political map. If England can maintain her position as a world power the United States will be able to determine the conditions of trade by controlling the flow of credits. And if Germany should remain a powerful nation the United States will be able to determine trading conditions by controlling the flow of goods. Mr. Hoover, in the same speech, stated his belief that "For a long time to come the function of gold in settlement of international balances will be greatly limited" and that the various postwar economic pressures will "make for increased barter trades or at least trades on a direct two-country basis." But Mr. Hoover has not taken into account the possibility that Germany herself, if victorious in the war, would not be interested in continuing her former import-oriented trade policy, in which she compelled her suppliers to finance her imports. More likely the exigencies of reconstruction would make her shift to a pronounced export-orientation, and there-

¹⁸ Quoted in *New York Times*, September 19, 1940, p. 14.

fore to a free world market based on a general lowering of tariffs—even though she might like to play there the role of a dumping monopolist. Her success in restoring wornout industrial and transportation equipment and in replacing exhausted stocks of raw materials would depend on her chances of selling German products—certain raw or semi-manufactured products as well as industrial goods—and she would therefore court the markets of the industrial countries which she has so conspicuously neglected in the past years. For this she would have to conform with their trading methods and accept the rules of the game, even if she tried to improve her position by making herself the controlling broker of Europe with regard to both imports and exports.

It is interesting to note that Germany is already preparing the ground for such a new trade policy, and trying to sound out the response of other countries, particularly the United States. Recently Emil Puhl, head of the German clearing office and vice president of the German Reichsbank, made it clear that the operations of the German clearing office could easily be extended to a system of multilateral clearing. According to a statement of his position, published in the *New York Times*,¹⁹ "The Reichsmark has become the dominating European currency . . . Thus, Reichsbank balances with the Berlin clearing office will, in the future, fill approximately the same role as gold or the pound sterling did in the past . . . The purchases of each country must be coordinated with its export capacity . . . the Reich should fill the role of intermediary . . . In this way every country would receive its just share of products for which the demand is strongest." Dr. Puhl concluded that "the new multilateral clearing system does not exclude merchandise credits or even gold transactions . . . if the United States is willing to import sufficient quantities of German goods." And nearly the same advances were made by the State Secretary in the Reich Ministry of Economics, Friedrich Landfried, who emphasized them more strongly: at the opening of the Cologne Trade Fair he declared that even the

¹⁹ September 24, 1940, p. 5.

time-honored medium of exchange, gold, will have its place in "the new Europe" "if the nation that today is almost the sole possessor of the world's gold places gold at Europe's disposal."²⁰ These utterances seem to be the first trial balloons for testing the United States' readiness to open up her markets in order to take part in Germany's plans for the restoration of Europe after the war.

It is not clear whether Germany would ask for credits to ease the time of transition; the National Socialists have been opposed to foreign banking credits on the ground that they would make Germany dependent. If she did not receive credits her export orientation would have to be pursued even more intensively.

The question, then, is whether the United States will use her strong strategic position to prescribe the trading methods that must be followed in order to obtain the business not only of this country but also of Ibero-America. And the question too is whether the United States, profiting by the example of Europe, will be able to recognize both the gravity of the danger and her remarkable opportunity to contravene it. But in concentrating on the future methods of trade between Europe and the western hemisphere we should not ignore the danger that trade volume itself will decline so greatly as to jeopardize the internal economies of Ibero-American nations and thus create a native fascism. In the first World War a German prince ridiculed the French General Staff, declaring that the French army is always excellently prepared to wage and win the past war. We should beware lest we resemble the French in the preparation of our postwar commercial policy.

²⁰ *New York Times*, September 16, 1940, p. 4.

THE GOVERNMENT AS A BUSINESS

A Consideration of Budget Problems in Relation to the General Welfare

BY HERBERT E. GASTON

THAT government is a business is an assertion that no longer requires proof. We have heard the statement time after time over many years. We have heard also its corollary—that what we need is more business in government, more of the application of business-like principles to government. The subject that I shall discuss here is the budget—the document that treats of government as a business, the annual financial statement of the government considered as a business institution. But before I begin a discussion of the budget let me make clear that I am writing only as an individual and as an observer. I have not a particle of responsibility with respect to the budget and no authority whatever to represent the government in a discussion of it. This I might add leaves me practically unhampered except by ignorance and prejudice, and in that respect I am more or less on an equal footing with many others who undertake the same task.

The Budget and Accounting Act of 1921 was an effort in the direction of applying business practices to government. It required the President to prepare and submit to the Congress annually the executive budget, which is the budget of the United States government. This document, which is prepared and submitted at the very middle of the government's fiscal year, is a three-part financial statement. The first part is a record of receipts and expenditures and other fiscal data for the fiscal year that ended six months previously. That part is retrospective. The second part is both retrospective and prospective. It deals with the fiscal year then half completed and is made up in equal parts of experience and anticipation. The third part is purely prospective. It is a detailed

estimate of receipts and expenditures for a twelve-month period that will begin approximately six months after the estimates are presented. It contains recommendations for appropriations for all the purposes of government in the ensuing fiscal year and estimates of how much of those appropriations and of reappropriations will be expended during the year.

Appropriations are voted by Congress and when approved by the President constitute authority to the Executive to make expenditures. The amount of appropriations does not measure the exact amount of expenditures. The Congress does not expend funds except for its own maintenance; it merely authorizes and limits their expenditure. Nor does the Congress provide funds, although it must authorize their provision by means of taxes, borrowing or some other method.

In one sense the budget is always balanced; that is, in the same sense in which all financial statements are balanced by the book-keeping entries which make the totals of the parallel columns identical. Even the federal government cannot make expenditures without providing from some source the funds from which they are to be made. If the anticipation of receipts is less than the estimate of expenditures, then the budget must show the source from which it is proposed that the deficiency be made up. This source may be borrowing or it may be realization upon existing assets of the government, such as balances in the general fund, or it may be new taxes, or a combination of all three.

This is, in substance, the nature of the executive budget. When we think of the budget as an outline of administrative policy—which it usually is—or as a financial plan for a period extending eighteen months ahead, it is the third part that we have in mind. When we speak of balancing the budget it is not always certain what we do mean, whether an anticipatory balance or one that has been realized. The distinction is not totally unimportant. There have been a number of instances of balances that were anticipated but not achieved. This is not surprising, in view of the fact that to attain even approximate accuracy in estimating either revenue or

expenditure—but more especially revenue—for eighteen months ahead, one must forecast with great precision not only general business conditions, but specific developments in various lines of industry and trade. Other and more directly human factors, including political factors, may also disturb the calculations.

But when we say, as we often do, that we have had so many years of unbalanced budgets in the past, clearly we are talking about experience rather than prophecy, about the retrospective financial reports rather than the succession of financial plans that were put forth in advance for those years. And when we read in a newspaper editorial or a political speech that the budget should or must be balanced, what is probably being demanded is a revision of governmental planning which will result in making public revenues match or exceed public expenditures.

The executive budget, together with the special technical machinery for assembling it, is the sound adaptation of a perfectly sound technique of private business to the business of government. Within its own sphere business that is competently managed is a believer in a planned economy. Business has taught government practical lessons in the value of planning. Long before government thought it necessary, business developed its corps of experts whose responsibility it was to foresee changing conditions, to recommend the adaptation of business to meet those conditions, and even to try to effect conditions favorable to the particular business.

Business planning embraces an attempt to foresee both business revenue and business expense for at least a year in the future. I believe it is not usually limited to the effort to reduce expenditures, but is more often chiefly concerned with how to enlarge the scope of the business. It may and often does authorize expenditures that will not be immediately profitable. It sometimes has special ways of accounting for these expenditures and holding them in suspense to be charged against the earnings of future years—if tax liability is not increased by the process. Business policy, if it is intelligent, does not have in view solely income and outgo for a single year. A mere statement of past and anticipated income and outgo would

not in fact be very illuminating if it were not supplemented by statements of profit and loss, assets and liabilities and other even more important supplementary facts which give an idea of the growth, the vigor and the worth of the business.

If we are to apply business principles and business standards of analysis to government finance we shall have to go a little further than receipts and expenditures in any given year or group of years. We can obtain some side lights on the economic and social history of the United States from the statistical tables in the series of annual reports on the state of the finances by the various secretaries of the Treasury from Hamilton to Morgenthau—and some very interesting side lights, too—but they are not the history of the business known by the firm name of United States of America. They tell us practically nothing about its product or its accomplishments, its profits or its losses. Strangely enough, they do not even tell us anything trustworthy about the liabilities or the resources of the business. With some minor supplementary information they are merely an account of moneys collected and moneys spent by the government.

The analogy with business leads us into some strange errors about the federal budget. The business-minded, those who are accustomed to reading annual reports of private and incorporated businesses, are likely to regard the federal budget as just another profit and loss statement and to attempt to judge it by the same standards. If there is a surplus it is a good statement, revealing a satisfactory state of business; if there is a deficit it is bad, and if there is a succession of deficits it is horrible. But the federal budget is not a profit and loss statement and it can be mistaken for one only by those who suffer from a strange complex which fills them with bafflement and frustration if they cannot see a profit or a loss figure set down in dollars and cents.

The government is truly a business, and it must be a business that returns profit or we would have abolished it long ago. But its profits cannot be measured in dollars and cents—certainly not in the dollars and cents of a budget statement. It just is not that kind

of business. What kind of business is it? It is a business whose purposes lie entirely outside the scope of ordinary fiscal accounting, whose profits may not be found in its budgetary statements—in fact may be looked for anywhere else but there—and whose resources are not measurable by any balance sheet of the government itself.

It may seem foolishly elementary to say that the business of any government is to promote the welfare and the real profit of all those who live under it. It is worth saying only because so many of us wear private business spectacles that make us see problems of government in a ludicrously distorted form and perspective.

Government in the United States has been concerned in the last hundred and fifty years with trying to do for the whole community which maintains it those things which seem to be needed and which obviously could not or would not be well done if left to private motive or haphazard volunteer cooperation. Certain phrases of its basic charter, to "provide for the common defense" and to "promote the general welfare," seem as sweeping a statement of purpose as could be devised.

In the evolution of government here those broad purposes have come to cover an increasing number of specific projects. As the scope of government has increased, dispute over new extensions of governmental activity has often been acute. Alarm drums have beat on occasion and there has been much talk about the peril to free initiative and to the American way of doing things. So far as I have been able to discern, the American way has in fact been simply to let the people decide how much and what they want their government to do for them. On the whole, I think they have decided on the basis of very practical considerations—considerations of pure expediency—and have not been too much swayed by those mystics who deal in word-associations and color schemes to discredit departures from precedent. Generally speaking, Americans ask about a proposed venture of government merely "What will it do for us?" and "Will it be worth what it costs?"

It is the function of government accounting to tell them what is

the cost—the dollar cost, that is—of each particular government activity. Government accounting alone cannot appraise its value. That must be judged by other evidence, including the evidence of individual welfare. The dollar cost and the availability of resources to meet it are of vital importance. The community is not free, any more than the individual, from the necessity of measuring one good against another and determining which is the more to be desired. But if it looks only to the government fiscal statement for the answer to that problem it will be deceived.

By this I mean simply that the compensating gain that may have resulted from any governmental expenditure may not and probably will not be reflected in the government's financial statement. I mean also that a budget deficit may not in the broadest and truest sense be a deficit at all. On the other hand a budget surplus may represent a loss and not a gain. These are but plain accounting considerations based on the essential nature of public business, which is inseparably connected with the general welfare and is not and cannot be an isolated collection of independent fiscal transactions. Of course this does not mean—and we shall have to be on guard against any such assumption—that every governmental deficit represents a public gain and every surplus a public loss. Quite to the contrary, it means that we must look outside the budget statistics to determine whether there is loss or gain—whether it has been a good year or a bad year for the business. We must also look beyond them to determine whether budget policies have minimized losses or enhanced gains that would have occurred anyway.

The government is able to draw upon the entire physical resources of its land and upon the productive energies of its people. These are its real and substantial assets. Where governmental policy wastes these assets there is a loss; where it increases them there is a gain. Budget statements and government financial statements have never reflected the almost fabulous resources gained by additions to our territory, by new mechanical and scientific progress, by new knowledges and new skills, by advances in productive efficiency; nor have they recorded losses caused by wasting and looting

of natural resources, by waste of manpower, by the crippling of productive capacity through needless disease and undernourishment and in other ways.

If we want to look sanely and intelligently at a budget problem or a budget record we need, I think, to view it in the light of all these considerations. There will still be room for differences in judgment, but probably not quite the same confusion of judgment that too often sterilizes discussion. We shall at least know what we are talking about.

In the eleven fiscal years beginning on July 1, 1919, and ending June 30, 1930, there were continuous budgetary surpluses. The public debt, which had been increased through war costs by more than thirteen billions of dollars in the single fiscal year which ended June 30, 1919, was reduced over this period of eleven years through the budgetary surpluses plus recovery on war goods by more than nine billions. The per capita reduction was from \$240.09 to \$131.49. The period ended, however, with the greatest economic collapse in our national history. National income produced fell from 83 billions in 1929 to 40 billions in 1932. The bare figures are shocking enough in themselves; but they are far more shocking when translated into individual human terms of unemployment, want, hunger, despair and the wreckage of human fortunes and human lives which were implicit in them.

This is a hard-headed generation in some respects. Some of us may accept the doctrine that calamity is a punishment for our sins, including the sins of pride, ignorance and avarice, but we look for a more specific explanation. We are well grounded in the belief that effects spring from causes and our common sense tells us that there must have been in the boom of the late twenties the seeds of the disaster that followed.

For months after the great collapse it was said on the highest authority that conditions had been all along and were still fundamentally sound. If we have learned anything at all on this point in ten years it is that conditions must have been fundamentally unsound. The master minds of the twenties took credit for a prosper-

ity that was to go on forever. It would be unjust to charge them with being the architects of the ruin that followed. That would be giving them too much credit as well as too much blame: it would be to accuse them of a plan, of which they were wholly innocent. They, too, had been living from hand to mouth.

A good case quite possibly can be made for the view that in spite of the great individual wealth accumulated in the twenties, in spite of undoubted advances in the standard of living, in spite of additions to the physical plant for processing and distribution of goods, the economic mal-development that occurred renders the budgetary surpluses achieved in that period completely illusory.

So grave a derangement could not be expected to yield to quick and easy remedies. The rebuilding has been slow. It is reflected in the budget of the federal government for the ten fiscal years which we have just completed. This has been the tenth year of continuous budgetary deficits, the seventh year of recognition of the fundamental sickness from which the economy of the common welfare suffered and of conscious, determined efforts to palliate and to remedy it. In these ten years the public debt of the United States has increased by some 27 billions of dollars, and in the last seven years by approximately 21 billions. The real increase, however, is not quite so great. Increase in cash and portfolio assets of the government reduces the whole addition to the debt to about an even 20 billions in the last ten years, and about 16 billions in the last seven years. Either of these figures is substantially less than the cost of two years of war. It should be remembered, too, that we have been paying costs of the last military war all through these ten years: in veterans' benefits and pensions a total in the ten years of some 9 billions; in interest on the residuary war debt of 1930 a total for the same period of about 5 billions. Without this war burden of some 14 billions the budget picture of the last ten or the last seven years would have been substantially different.

In the last complete fiscal year, ending in June 1940, total expenditures of the government were greater than for any other year and there was a net deficit of 3.6 billions. But for that year receipts

were sufficient to cover the following and leave a small balance: all ordinary expenditures of the government, including a billion and a half for the army and navy; operation of the civil departments of the government; veterans' benefits; the agricultural adjustment program; interest on the public debt; and all expenditures for public highways, public buildings, rivers and harbors and flood control. Unemployment relief and grants to states under the Social Security Act accounted for about 2.2 of the 3.6 billion deficit.

This is typical of the federal budgets over the whole period of seven years. The deficits have been incurred almost entirely to provide work and a living for those who would otherwise have been unemployed and in want. The work that has been done has been useful work. Probably in no equal period of the country's history have so many improvements been made on the physical plant which is the common property of the people of the country and which exists for their use. Every community in the land has been benefited by new public structures—schools, hospitals, libraries, other public buildings, roads, streets, sewers, airports, parks, playgrounds. This has all been done without any overall increase in state and local debts, which have in the aggregate actually declined during this period.

There is no waste quite so tragic and so irrecoverable as the waste of productive effort, the waste of manpower, while need of the products of productive effort exists. There has been such waste in the last seven years—there has been such waste on a huge scale throughout our entire history—but there can be no doubt that deficit spending has prevented that waste from assuming the appalling dimensions that it would otherwise have assumed.

Both the ordinary and the emergency divisions of the budget reflect, in addition to the sums expended on relief construction and relief payments, a great many measures intended to remedy fundamental weaknesses in the economic structure which were developed in the boom years and disclosed in the collapse. How effective those measures have been can in part be judged by general results. That most of them are generally approved seems evident from the lack

of demand for their abandonment. They include appropriations for the strengthening of the capital structures of banks, stricter regulation of the conduct of banks, insurance on bank deposits, provision for direct loans to railroads and to industry, provision for the underwriting of sales to foreign countries, the establishment of a comprehensive system of cooperative rural credit under government supervision, a system of subsidies for soil conservation and other aids to agriculture, creation of a commission to regulate transactions in securities, provision for the refinancing at low rates of both farm and home mortgages, a system of insurance on mortgages for the construction and improvement of homes which has resulted in a great spur to home building, a new system of loans on essential agricultural commodities which prevents their being dumped on the market at distress prices, the diversion of unmarketable agricultural surpluses to relief under a system which insures raising nutrition standards. And to these must be added other measures of very great social and economic significance, the National Labor Relations Act, the Wages and Hours Act, and, finally, the Social Security Act.

This is not an exhaustive list, but it is enough to show that government has been grappling with the basic faults in the economy of the nation. There is other evidence of this in the work of the National Resources Committee, and in the fundamental fact-finding work of the Temporary National Economic Committee.

Most of these programs are innovations, but they are not nearly so precedent-shattering as many people suppose. The United States has tampered with its national economy from the very beginning. It has frankly used tariffs as an instrument to build home industry; it has taxed to curb and to destroy; it has subsidized and regulated many forms of communication and transportation; it has given away land to promote settlement and exploitation and tardily reserved some of it in the interest of conservation; it has promoted or restricted immigration as the needs of the particular era seemed to require. It has encouraged some monopolies and discouraged others. Even publicly financed work relief is not a

wholly new thing. What is new about it is the adoption of a nationwide work relief policy and the recognition of national public responsibility for unemployment.

We have seen, not a revolution, but an extension of a principle recognized from the foundation of the government, that "general welfare" includes economic and social welfare and that the government has broad powers and broad responsibilities in seeking that objective.

It seems obvious that the government as a business is but a part of a much greater business. Deficits and surpluses in government finance give no clue to the profits or losses of the greater business. In measuring costs against gains, deficits in the governmental budget have no independent significance. More significant are the whole costs of government and especially the added costs through which economic gain or the prevention of economic loss is sought. It seems plain that the usefulness of all types of governmental expenditure should be frequently examined and reexamined. Only by that process can we have any assurance that we are making progress toward the ends we seek.

Deficits, however, have a special significance in another direction. They affect the availability of resources to meet expenditure. They represent the postponement of revenue collection. In so far as they are not offset by actual addition to governmental as distinguished from public assets, they constitute a net addition to the national debt. The question is, how long may they be continued and still constitute sound public finance? When should the budget be balanced?

An unbalanced budget can be balanced only by a rise in revenue or a fall in expenditures or a combination of both. It is my personal belief that expenditures can safely be cut only when the cuts will not cause more loss to the public economy than gain to the public purse. Revenues will rise merely through betterment of economic conditions—we have seen this happen in the last seven years. But levying new taxes or increasing tax rates in order to increase revenue should meet the same test as proposed cuts in ex-

penditure: they should not produce economic losses greater than budget gains.

It may be objected that the application of these simple rules might lead the country into exhaustion of its credit and bankruptcy. I think this could not result if the tests were applied with good judgment. Betterment of the economy through deficits must mean genuine betterment—increase of our resources and capacity to pay for the costs of government. We must continually make sure that the gains are real and not illusory.

I shall not attempt to tell you in what year the budget should be balanced or at what dollar amount of revenue and expenditure. To do that would be to deny what I have just said. I will add, however, a few opinions—and, again, very personal opinions—about our present situation.

I do not claim there has been no waste in governmental expenditures in the last seven years, but I do contend that, taken as a whole and in the light of the results, the expenditures have justified themselves; that they represent, not a loss, but a profit. The general and the statistical evidence pointing to this conclusion is abundant. One item is that of national income produced, which is estimated at 69.4 billions for last year and has averaged 67.4 for the last four years, as against 40.1 in 1932 and 42.4 in 1933.

Much of the addition to annual governmental expenditure will be permanent. We cannot afford to go back to 4 billion or even 5 billion dollar budgets. There is too much to be done. By ruthless cuts in expenditure the budget could be balanced for the next fiscal year if that were the supreme objective. Budget-balancing is not the supreme objective, however, and cuts of that character would be disastrous, foolhardy and unsound finance. The same thing can be said about drastic increases in revenue, especially in the form of sales taxes or other recessive taxes. But we can and we should increase the yield of the tax structure by forms of additional taxes that will not restrict consumption and will not handicap progress. I think the government will need more revenue for the job it has to do than the present tax structure will provide.

The existing public debt is not a menace and we are not threatened with national bankruptcy. There is not the slightest sign of any weakening of the public credit and no reason for anticipating it. Although the absolute size of the public debt has doubled in seven years, the cost of carrying it, and therefore its burden on the public purse, has increased much less—only 51 percent from the fiscal year 1933 to the fiscal year 1940. The computed annual interest charge was only 4 percent greater as of June 30, 1940, than for the same date in 1919.

To say that there is anything in the American tradition which makes it improper for the government to try to influence the functioning of the general economy is to ignore the essentials of American history. Those who complain of government interference with business complain even more bitterly when there is a proposal to abandon a form of interference which is profitable to them and which they regard as a vested right.

The point of view which represents taxes as a slice taken out of the national income, an irreparable loss to the taxpayer, is as absurd as would be the claim that railroad revenue—or telephone, or electric light and power revenue—is also a deduction from income and therefore a net loss. This whole conception of taxes and public expenditures as waste and loss is a doctrine of anarchy. It has no other meaning.

Anarchy will not solve the intricate problems of an economy that has been growing ever more closely integrated and complex. If we say that democracy cannot grapple with these problems, then we are surrendering democracy to defeat and proclaiming that the tyrants shall inherit the earth. If on the other hand we take a realistic view of the assets and liabilities of our government as a business, if we include considerations of the welfare of the people in our consideration of the welfare of the budget, then I think we shall have chosen the only sound course to meet the challenge of the complex modern economy. We shall solve the new problems with the American capacity and will to live and to go forward.

(Assistant Secretary of the Treasury)

FULL EMPLOYMENT THROUGH TAX POLICY?

BY GERHARD COLM

The Problem

FISCAL policy, spending as well as the collection of revenue, necessarily affects the level of income, production and employment, temporarily or permanently, by directly creating or destroying active purchasing power, by transfers in purchasing power, and by affecting the behavior of individuals as businessmen or consumers. Transfers in purchasing power and changes in the behavior of individuals also result indirectly in the creation or destruction of active purchasing power. There is no fiscal policy without effect on purchasing power: the question is only whether these economic effects are desirable or undesirable. Therefore we cannot dismiss the problem of directing fiscal policy in accord with the objectives of economic policy by saying that fiscal policy should be used only for purely fiscal objectives.

It is assumed in this article that full and steady employment is not brought about by market automatism under present conditions. That it is not must be attributed to structural or secular developments which are periodically aggravated by cyclical factors. These difficulties can adequately be called problems of a maturing economy, although this term has often been misinterpreted.¹ A maturing economy differs from a stagnant economy as much as maturity differs from senility.² It does not mean a satiated economy, so far progressed that nothing is left for further development.

¹ See Gerhard Colm's "Comments" on W. I. King's "Are We Suffering from Economic Maturity?" in *Journal of Political Economy* (February 1940).

² The term maturing economy adequately expresses the fact that different phases in economic development have different structures and that we are in a transition from one phase to another. The mechanisms of economic expansion and the processes of adjustment change with these phases.

With one third of the nation "ill nourished, ill clad and ill housed," with the need for economic development of distressed areas and the need for many public improvements, it would be ridiculous to speak of an absolute lack of investment opportunities or of a surplus of labor. The term maturing economy can be used, however, to denote a very significant development. It can be used to label a stage of economic development in which the interest and price mechanism fails to direct the productive forces of the nation into work urgently needed. There are open spaces and new frontiers for economic development but their conquest requires methods supplementing those described in classical economics. The reasons for the failure of the market automatism to bring about the needed development will not be discussed in detail in this article. For our purpose it is sufficient to assume that the market mechanism must be supplemented by economic and fiscal policies adapted to the conditions of a maturing economy in order to bring about full and steady employment of the productive forces. Existing potentialities permit a tremendous development in private and public standards if full and steady use can be made of all productive forces.

The problems of the maturing economy are partly concealed, partly aggravated by the international political conflicts. It has been said that armament is the new industry causing economic expansion as the railroads or power production did in earlier phases. Armament creates a great demand for factories and manpower, but it also leads to the problems of a postwar or postdefense adjustment. Armament cannot solve but can only postpone the fundamental problems of our economy; it must aggravate them at a later time.

The need for a reorientation in cyclical policy was felt during the Great Depression. When it was realized that variation of the bank rate—the traditional tool of a cyclical policy—was not effective enough, many economists advocated a policy of public works, of "pump priming" government spending, as the solution. Yet in spite of the fact that this policy proved quite effective in several countries, it could not be regarded as a solution of the

whole problem. Public opinion in general was skeptical and even underestimated the actual success of the policy. I do not intend to examine here the various objections leveled against the spending policy and the resulting increase in government debt; whether this criticism was justified or not it resulted in raising the question of whether the same objective could not be achieved by means of a flexible tax policy rather than by a spending policy. It seems especially urgent to explore this question now with respect to the future postdefense adjustment, because when the defense program is terminated a new spending program would probably meet even greater resistance in many quarters.

Doubts of the efficacy of spending became pronounced when it was realized that the task of economic policy consists not only in restoring employment from the depression low to a high level, but also in maintaining it at the high level. The notion that it is necessary only to inject purchasing power by deficit spending and that the additional money will then remain in circulation was based on a defective monetary theory. The hope that increasing business activities would bring about tertiary effects by inducing new investments in many lines of production was justified, but the quantities of such induced investments were not sufficient to sustain a high level of employment without government outlays. The underlying causes of the depression are not removed by an injection of purchasing power, and a high level of income and employment cannot be maintained without a fundamental adjustment of the economic structure. Thus the focus of the discussion shifted from the problem of recovery to the problem of basic structural adjustments.³

The question was raised of the role that fiscal policy could play in an effort to bring about a permanent adjustment of the economy. Those who regard the discrepancy between the propensity to save

³ See Alvin Hansen, *Fiscal Policy in Relation to the Business Cycle and Chronic Unemployment* (manuscript in preparation for publication). For the whole range of problems discussed in this article see the forthcoming book by Dewey Anderson, *Taxation and Recovery*, which will be published as Monograph 20 by the U. S. Temporary National Economic Committee.

and the demand for capital as one of the fundamental maladjustments conclude that fiscal policy can play an important role with respect to structural adjustments. Such fiscal policy must either absorb savings through continued government outlays of borrowed funds or reduce savings by taxation. Spending would meet even more opposition as a permanent than as a cyclical device. Therefore the question must be raised, with respect to cyclical and even more to structural adjustments, of whether tax policy can accomplish the objectives which have been assigned to a spending policy.

The Regulation of Purchasing Power by Tax Policy

1. *Creation of purchasing power by tax reduction.* When deficit spending was proposed as a means of creating purchasing power it was suggested that a deficit brought about by tax reduction would have the same effect.⁴ Those who object to deficit spending not because of the deficit and the increase in government debt but because of their dislike of increased expenditures prefer a reduction in taxes to an increase in spending as a recovery policy.

A deficit which is brought about in a depression by maintaining the level of expenditures in spite of declining revenues has been called a maintenance deficit.⁵ It prevents the downward spiral of the depression from spreading because it helps to maintain the incomes derived from government expenditures. Except in the case of a substantial decrease in the costs of living this policy cannot lead to an actual increase in purchasing power and to reemployment. It is a device for moderating the effects of the depression but not for bringing about recovery.

The situation is changed if a drastic reduction in tax rates is considered, depending on the types of taxes that are reduced. A reduction, for instance, of corporate income taxes in a time of depression would have little effect on the active purchasing power.

⁴ See, for instance, *Savings and Investments*, Hearings before the U. S. Temporary National Economic Committee, part 9 (Washington 1940) p. 3553.

⁵ See Gerhard Colm and Fritz Lehmann, "Public Spending and Recovery" in *Social Research*, vol. 3 (May 1936) pp. 130 ff.

The same probably holds true with respect to a reduction in progressive income and estate taxes in such a situation. The case is different, however, with respect to a reduction in consumer taxes. The lowering of sales tax or payroll tax rates may lead to lower prices and an increase in consumer purchasing power. This may have an effect similar to that of an increase in purchasing power brought about by additional spending.

The respective efficacy of increased spending or reduced tax rates depends on the time lag existing in both cases between the enforcement of the measure and the actual increase in purchasing power. This time lag varies in different cyclical situations. A reduction in sales taxes or payroll taxes would probably not be very effective when some improvement in market conditions had already occurred. In such a situation it is likely that the tax reduction would result not in lower prices but in increased profits, and the active purchasing power would not rise until much later. Under the impact of a depression with its pressure upon the price level, however, such a tax reduction may quickly result in increased purchasing power for the consumer. Consumers will react differently to an increase in purchasing power due to a reduction in prices and one due to an increase in money incomes resulting from additional spending. The decrease in prices is probably more conducive to additional buying, but on the other hand additional government spending during the depression may place the purchasing power more directly into the hands of those who are worst hit by the depression.

During the Great Depression the federal government as well as state and local governments imposed many new consumer taxes (sales taxes, excise taxes, payroll taxes)⁶ and thereby probably aggravated the depression. If our future defense financing should include the imposition of a heavy tax on consumers, such a tax should be eliminated or drastically reduced as soon as the defense

⁶ Gerhard Colm and Helen Tarasov, *Who Pays the Taxes?* Monograph 3, U. S. Temporary National Economic Committee (Washington 1940), especially table xi, page 29.

expenditures are curtailed. This is not to suggest, of course, that the mere reduction of the tax would suffice to bring about the necessary postdefense adjustment. It would, however, be one important element in a comprehensive program.

2. *Limiting the increase in purchasing power by tax increase.* Tax policy is even more effective in limiting or curtailing than in creating purchasing power. The objective of defense financing should be the mobilization of all available productive forces so that the maximum defense effort can be combined with a maximum supply for civilian purposes. This aim leads to the recommendation of borrowing and of progressive income and profits taxation as the main methods of defense financing as long as unemployed men and idle facilities are available. With the exhaustion of idle resources it becomes necessary to shift the emphasis to a method of financing by which the increase in purchasing power and consumption will be limited. Some sort of consumption taxes will then become necessary.⁷

Such a restrictive tax policy may become necessary even before all the unemployed are absorbed. In the boomlet of 1936-37 bottlenecks in some types of labor and facilities developed into what could be called a production jam accompanied by forward buying and speculative inventory accumulation at a time when there were still millions of unemployed. This led to restrictive fiscal policies and the ensuing recession. Such violent fluctuations must be remembered as an example of what to avoid in the defense effort. The use of flexible taxation designed to regulate the increase in purchasing power in accordance with the increase in production could assist in such an objective. In the defense effort it is quite obvious that a variation in spending is limited to the non-defense expenditures, and that the necessary variation must therefore be confined to the revenue side of the budget. The need for a flexible tax policy

⁷ For such purposes either selective excise taxes or a kind of general consumption tax or both could be considered. A turnover tax, measured by "value added," with tax credit for federal and state payroll taxes, should be examined as a possible general consumption tax.

creates a difficult but not an insoluble task for legislation and administration. It must be realized that a flexible fiscal policy must do the job which was assigned in classical economics to the central bank policy, but which a central bank policy was unable to accomplish alone. The more boldly fiscal policy is designed to mobilize all productive forces, to strive for full employment, the more necessary it is to install an effective and smoothly operating brake in the economic system.⁸

The Regulation of Savings by Tax Policy

1. *The problem of oversaving.* Oversaving is one of the main problems in a maturing economy.⁹ The saving-investment relationship is the feed line through which purchasing power is added to or leaks out of the economic process. If the gasoline line of an engine is clogged the motor will not run properly. The interest rate does not keep savings and investments in such a relation that full and steady use of the productive forces is assured. An injection of purchasing power cannot result in increased production and employment if there are maladjustments for instance in the price-cost relationship. Of course it is also true that an ample fuel supply cannot make the motor run if internal frictions are too great and the parts do not fit together.

When a country is in the early stages of its economic expansion the level of incomes and therefore of savings is still low. Foreign capital is attracted and credit created; purchasing power is added to the income stream, the income-level rises. Investments anticipate demand and thereby create an increase in income. In the later

⁸ Flexible tax policy is not recommended as the only measure for preventing a production jam. Training of workers, the stimulation of a farsighted program of plant expansion, price and wage policies, and, if necessary, limitation of speculative inventory accumulation are examples of non-fiscal measures.

⁹ The term "oversaving" is misinterpreted as often as the term "maturing economy," to which it is related. It is not an adequate designation of the phenomenon but is used since no better term has been coined. No technical discussion of the theory of oversaving is intended here: for the purpose of this paper it is sufficient to indicate the nature of the problem. It should be emphasized again that the theory of oversaving does not imply that technical progress is slowing down or that there is no room for further expansion.

stages of development investments tend to increase in proportion to the rise in incomes while savings increase substantially faster than incomes.¹⁰ A surplus of savings over investment must cause a deflationary movement unless it is absorbed by capital export. Such export of capital was part of Great Britain's solution for several decades and also reduced the problem in the United States during the 1920's. Other extraordinary factors, such as the realization of capital gains and an increase in consumer credit, augmented dissaving, or the dissipation of savings, in the "New Era" period with the result that the problem of oversaving was temporarily concealed, although not solved.

For Europe the last war created an extraordinary investment demand first for armament and then for reconstruction, so that the problem was more one of undersaving than of oversaving. Fiscal policy was often used as an adequate instrument for stimulating individual and corporate saving. Now again armament and destruction are "solving" the problem of oversaving for a large part of the "civilized" world. Mankind has found most ingenious devices for conquering the problems of scarcity: can it find no other way of solving the problems of wealth than destruction of it? But granting that this continent will not be subjected to total destruction and that only a moderate portion of its savings will be absorbed by postwar reconstruction, then the problem of oversaving will appear again in its full weight. Postdefense adjustment must consider many dislocations in prices, costs and production, but the main problem will be that a high income-level corresponding to full employment cannot be maintained unless all the savings which are expected at such a level be offset by dissavings or led into investments.

Fiscal and economic policy can affect saving and investment in many ways. The problem is so big that all available devices, fiscal and non-fiscal, must be applied so that the individual and social benefits of thrift and foresight can be made compatible with the

¹⁰ The relation between saving and national income depends not only on the level but also on the distribution of the national income.

request for full and steady employment. Fiscal policy can aid in the solution in two ways: by absorbing savings for financing government outlays and by taxing funds which would otherwise be saved and using them to finance consumer expenditures.¹¹

Once a high level of employment has been reached only such government outlays as can increase the productivity of the economy should be financed by borrowing. It can be assumed that the federal, state and local governments will have a substantial amount of necessary productive improvements to be made which can be financed by loans without violating the rules of sound finance.¹² On the other hand the whole problem probably cannot and should not be solved in this way. Corporate and individual savings which are not otherwise fully absorbed should also be curtailed by taxation and transformed into consumption by current government expenditures.

2. *Curtailling individual savings.* Progressive income and estate taxation has cut down individual savings. Is it possible to stiffen these taxes and thereby further cut down individual savings? There are still substantial loopholes in personal income and estate taxation, yet the use of this tax instrument for the curtailment of individual savings is not unlimited. In this context the problem arises of a scarcity not in the supply of capital but in the supply of the risk-factor in production. Changes with respect to this factor have resulted by no means exclusively or predominantly from tax policy, but tax policy has aggravated the problem.

¹¹ Financing social security benefit payments by taxation of incomes, estates or business funds would have such an effect to a great extent. A revised social security plan may play an important role in postdefense adjustment.

¹² Sound finance requires a fiscal policy which does not imply constantly rising tax rates. In a period of full employment debts should be regularly incurred only for fiscally productive purposes: for expenditures which cause taxable income and revenues to increase in proportion to the increase in interest payments. Tax rates will then be lifted to a higher plateau only if the government assumes additional functions. In a period of unemployment and unused capacities, however, the increase in national income may be so large, as a result of borrowing, that the increase in interest payments appears relatively insignificant, provided that the high income-level can be maintained.

3. *Curtailling corporate savings.* Corporate savings are as important as individual savings as a possible source of deflationary tendencies. The undistributed profits tax was a device for curtailing one possible source of corporate savings by subjecting profits either to the heavy rates of individual income taxation or to a compensatory tax if the profits were retained in the hands of the corporation. An undistributed profits tax of one type or another is a necessary complement to a stiff individual income tax.¹³ As a device for curtailing possible accumulation of idle corporate funds this tax was rather defective because it affected only one of the various sources of corporate accumulation of funds and it made no distinction between funds actually used for investment and funds kept idle. In addition it happened to be enacted in a phase of the business cycle when such a curtailment of corporate accumulation was not desirable. Yet there may come again a time when it is held desirable to adopt a tax which actually curtails idle corporate funds and it may be worth while to investigate whether such a tax can be devised.¹⁴

A tax on idle business funds: A tax on idle business funds should be measured by the sum of profits and depreciation and depletion minus the amounts invested or distributed as dividends. The first difficulty arises with the need to define investments: should they include the purchase of stocks of other corporations or of government bonds? It is proposed here that amounts spent for these purposes should not be regarded as investments in the meaning of such a tax law. Should the increase in inventories be regarded as investment? It may be advisable to discourage speculative accumulation in inventories which is one of the main factors causing the heavy short-run fluctuations. From this point of view it might be recommended that only such additions to inventories which correspond to a proportional increase in business activities be regarded

¹³ See National Tax Association's "Final Report on Federal Taxation of Corporations," *Proceedings of the 32nd Annual Conference on Taxation* (Columbia, S. C., 1940) pp. 534 ff.

¹⁴ Such a tax would not make superfluous a measure for bringing undistributed profits under individual income taxation.

as investment. Investment then would be defined mainly as construction or repair of plant and addition or replacement of equipment.

A tax on non-invested funds, as here defined, would create great difficulties for enterprises which must accumulate depreciation funds over a period of years before they can spend money for replacement of plant and equipment. When they make such replacements the expenses in a particular year are greater than the current accrual of funds. Therefore there must be a provision allowing a tax claim or credit to enterprises which in a specific year distribute or invest more than their annual accrual. These claims would not be payable in cash but would either be used to offset tax liabilities which had originated in earlier years or be carried forward to offset tax liabilities of later years. The tax should be constructed in such a way that its amount would depend on the length of the interval between the accrual and the investment of the funds. There would be no tax if funds were accrued and invested in the same year. The longer the period between accrual and investment, the heavier the tax should be.

Such a measure could be constructed in the following manner. A tentative tax of a given percentage, say for example of 30 percent, could be imposed on the non-invested and non-distributed funds accrued in a specific year. Whenever the invested or distributed funds are higher than the accrued funds in any taxable year, the taxpayer acquires a claim *pro tanto* against the taxing authority. The tentative tax payments form a tax deposit for each taxpayer from which the tax credits are deducted.¹⁵ The balance of the tax deposit will abate each year at a certain percentage. The annual rate of abatement could be, for instance, 20 percent of the deposit, which then would be the definite tax.

It may be objected that such a scheme imposes a hardship on those enterprises which by their very nature require a long period

¹⁵ The fact that the tentative tax payments are regarded as additions to the taxpayers' deposits need not prevent the government from using the money immediately. The deposit is only a bookkeeping device for computing future tax liabilities.

of fund accrual before they can replace their property. That would be the case, for instance, with businesses which have a high proportion of assets invested in buildings. It would be easier to synchronize accrual and use of funds in the case of businesses whose assets consist to a great extent of machines which can be replaced piece by piece. Such a hardship could be eliminated by relating the rate of abatement for each taxpayer to his average rate of depreciation (depreciation as a percentage of depreciable assets of the enterprise). The rate of abatement could be, for instance, three times the average rate of depreciation of the enterprise. If an entrepreneur erects a new plant with outside funds he acquires a claim which may be carried forward as a tax credit against his liability on future accrual of funds. The tax claim, however, should abate at the same rate as the tax deposit.

There are still several technical details, such as exemptions, which must be worked out for this tax plan. The plan is proposed not as a solution but rather as an illustration of one possible means of solving the problem of taxing idle business funds. There may be better and simpler methods of achieving the same objective.

Whatever the technique of such a tax, however, it should be handled in a flexible manner corresponding to the business situation. Although oversaving is considered a phenomenon characteristic of the present phase of economic development, it changes in degree and may even disappear temporarily—for instance, under the impact of an increased defense program or a large-scale program of reconstruction. If investments or dissavings (in Keynes' meaning of the terms) increase much beyond the expected level, a drastic curtailment of individual and corporate saving by taxation may be not only unnecessary but even harmful. On the other hand if the curtailment of savings should prove very effective, the financing even of public improvements by taxation may become the appropriate policy at a future time. Under conditions we must soon expect, however, it seems necessary to combine the two methods, the absorption of savings for public improvement and the curtailment of savings by taxation.

Incentive Taxation

1. *Objectives of incentive taxation.* The idea that the imposition of a tax or the offering of a specific tax exemption affects the behavior of the taxpayers and can therefore be used to bring about a desired reaction is much older than the term "incentive taxation." A tax on liquor has often been praised because it either produces revenue or deters people from drinking. Prohibitive tax rates have often been used for regulatory purposes. Tax exemption for government bonds was granted for the purpose of stimulating investment in such securities. The only new element in the proposals for incentive taxation consists in the fact that its techniques are now recommended for use in a recovery or reemployment program.

Incentive taxation appears in two forms, either as a punitive tax on a behavior held undesirable or as a tax exemption for those conforming to a behavior held desirable in relation to the objective of reemployment. I propose to speak in the first case of "corrective taxation," in the second of "tax inducements."

2. *Stimulation of employment.* Proposals for incentive taxation can be classified according to whether they attempt to stimulate employment directly, or indirectly by increasing demand. Plans of the first type advocate imposing a corrective tax on entrepreneurs who do not make full use of their facilities and dismiss employees, or granting a tax inducement to those who make full use of their facilities and increase the number of their employees. Examples of such schemes are the Papen Plan,¹⁶ the individual reserve system in unemployment insurance (the Wisconsin Plan), or one part of Hazelett's proposal.¹⁷

Some of those who propose incentive taxation of this type think

¹⁶ See Kenyon Edwards Poole, *German Financial Policies, 1932-39* (Cambridge 1939). Poole does not agree with my appraisal of the results of the Papen Plan (in *Social Research*, vol. 1, February 1934, pp. 83-96) but I find little evidence for his more favorable judgment.

¹⁷ C. William Hazelett, *Incentive Taxation, A Key to Security* (3rd edition, New York, 1939). Another example is a bill pending before the Pennsylvania legislature (Session 1938, House Bill 237: An Act to encourage employment, etc.).

in terms of a somewhat naive psychological interpretation of the depression. "Incentive taxation is a tax on ignorant selfishness" or "Incentive taxation is a proposed law of mutual service which is the law of love" or "Incentive taxation requires that we shall be 'good stewards.'"¹⁸ According to such views depressions are caused by entrepreneurs who fail in their duty to produce with all their facilities. As far as the entrepreneur is concerned the incentive to make profits by production and the penalty of high overhead costs should suffice to make him interested in full employment. Most manufacturing entrepreneurs produce for their customers, and production cannot be stimulated by low wages or by tax inducements or by any other means unless there is a demand for the products. It is a fallacy to believe that a depression can be overcome by stimulating production and that production then creates demand, in accordance with J. B. Say's law of the market. In reality the causal nexus proceeds for the most part in the other direction: demand must be activated first and production will follow.¹⁹

3. *Stimulation of demand.* Tax proposals designed to increase production and employment indirectly by affecting demand appear much more promising. Experiences of foreign countries show, for instance, that the provision to allow a deduction in income taxation for money spent on the redecoration of a house or for salaries paid to servants was quite effective. Tax exemption granted for the purchase of automobiles or for new residential houses also belongs in this category. It can be assumed that in such cases money will often be diverted from other use to the privileged use, but in many instances the taxpayer may be induced to spend hoarded funds for these purposes. In these cases the tax incentive really can contribute to a moderate amount of recovery and reemployment.

¹⁸ Hazelett, cited above, pp. 191, 192.

¹⁹ It is of course not denied that production often anticipates an expected increase in demand. Yet there must be some visible sign of such an increase in demand, or it will not be anticipated. I do not pretend to have exhausted the problems of anticipating production in these few remarks. There is a great need for realistic studies in this field.

As was pointed out above (page 451) a general reduction in taxes on consumption can be quite effective if enforced at the right moment. This is not a case of incentive taxation, however, but an increase in the consumers' real purchasing power.

Another method of stimulating demand consists in offering tax inducements for investments.²⁰ The Canadian income tax law may be mentioned as an example of this type of incentive taxation. It provides that 10 per cent of capital expenditures made within the taxable year on plant construction or extension and on modernization of machinery and fixed equipment be permitted as a deduction from profits.²¹ Such an inducement has an effect similar to that of a corresponding decrease in interest rates. It has been said that such an incentive may increase employment for the moment by stimulating the demand for building materials and equipment, but very soon must lead to increased difficulties in a period in which we are already suffering from excess capacities; that consumer demand, not the demand for new productive facilities, should be stimulated. It seems to me that no entrepreneur can be induced to expand his productive facilities unless he expects an increase in demand. Such tax inducements could be effective if industry were deterred by an excessive interest rate from making investments, but in general this is certainly not the case in a depression. On the whole therefore such incentives are ineffective. Only in very specific cases involving high risks or other high cost factors can a tax inducement help to compensate these adverse conditions. If such costs, and not the potential lack of demand, are the obstacle, then tax inducements may have some influence.

²⁰ "It is urgently recommended that Congress experiment for the next five years at least by trading tax credits against dollars actually invested by industry in modernizing, expanding, or developing production, and for additional employment."—*Survey of Experiences in Profit-Sharing and Possibilities of Incentive Taxation*, Report of the Subcommittee of the Senate Committee on Finance, 75th Congress (Washington 1939) p. 286. This report clearly recognizes the difference between stimulating production directly and stimulating demand (see p. 285).

²¹ For additional examples see the National Tax Association's "Preliminary Report on Federal Taxation of Corporations" in the *Proceedings of the 31st Annual Conference on Taxation* (Columbia, S. C., 1939) pp. 597-631 and their "Final Report," cited above, pp. 590-92.

The special amortization for investments in defense industries may be mentioned as an example in this context. Another example is the proposal to exempt from federal taxes that part of the profits of ship operators which is deposited in an approved construction reserve fund and will later be used for approved ship construction.²² Such tax inducements can hardly be considered as a general recovery device; their justification and effectiveness must be weighed in each particular case. It must be made certain when such exemptions are granted that they shall not then become an established right which may be retained long after the situation which gave rise to them has disappeared.²³

A further method of stimulating demand consists in the imposition of corrective taxes on idle funds, not in an effort to absorb such funds through taxation but as an incentive "designed to promote the circulation of money so that it may earn interest for the owner."²⁴

A tax on demand deposits with the intention of driving liquid funds into "productive" investments has been proposed several times.²⁵ None of these suggestions solves the problem of how currency holdings can effectively be taxed. In addition to this technical difficulty the proposal rests on the theory that there is a lack of supply of capital in the depression, while in reality the lack is much more in the demand for capital. Furthermore there is already

²² See *Tax Exemption—Construction Reserve Fund*, Hearings before the House Committee on Merchant Marine and Fisheries, 76th Congress, 3rd Session (Washington 1940).

²³ The classical example of such a case is the special depletion provision granted as an inducement to stimulate discovery of new oil and gas wells during the World War. This provision remained on the books when the problem of the oil industry had become overproduction, and a tax inducement was in full contradiction to other measures of government policy. See Clifford Hynning, *Taxation of Corporate Enterprise*, Monograph 9, U. S. Temporary National Economic Committee (Washington 1940) chapter 2.

²⁴ Hazelett, cited above, p. 66.

²⁵ See the discussion of such proposals by Emile Despres at the meeting of the American Economic Association, December 1938, in *Papers and Proceedings*, Supplement to the *American Economic Review*, vol. 29 (1939). See also *Unemployment* (reports of the various committees of the Nonpartisan Conference) House of Representatives, 76th Congress, 3rd Session, Document No. 850, pp. 17 and 75 ff.

quite an incentive for investors to prefer "productive" investments like stocks to hoarding. It can hardly be assumed that a tax, at least of a moderate rate, can achieve what the substantial difference in yields which already exists cannot accomplish.

4. *Influencing "marginal" decisions by taxation.* Generally it cannot be expected that an entrepreneur may be induced to produce when he has no orders, or to expand when there are still idle facilities. Yet there may be some less ambitious objectives which can be pursued by a policy of incentive taxation.

A tax incentive may induce an entrepreneur not to increase production but to distribute a given or expected volume of production more evenly over the year. The individual reserve plan of unemployment insurance cannot bring about reemployment and recovery, yet such measures may assist in mitigating seasonal fluctuations. It may help to avoid dismissal and rehiring of workers if a tax advantage is obtained by maintaining greater continuity in employment. Tax considerations may become one of the factors determining a corporation's location of a new plant or methods of financing (for example, equity vs. loan financing). Similarly it can be expected that the tax on idle business funds discussed above (pp. 456 ff.) may actually induce entrepreneurs to synchronize more effectively the accrual of funds and expenses for repairs and replacements. Even though only such repairs and replacements as are planned anyway are undertaken, the tax incentive may affect the timing in a way which may mitigate fluctuations.

Taxation may also affect the technique of production and thereby the volume of employment. A very interesting proposal with this purpose has been sponsored by Senator O'Mahoney.²⁶ In his bill "To Reduce Unemployment" Senator O'Mahoney proposes that the federal government levy a new tax on the "labor-differential" income of profitable corporations. Labor-differential income

²⁶ See the bill, S. 3560, 76th Congress, 3rd Session, and the articles by Senator O'Mahoney and Karl Karsten in the *Journal of Electrical Workers and Operators* (March 1940).

is defined as gross income minus (a) costs of materials and supplies purchased and used during the taxable year, and (b) total payroll except remuneration above \$3,000 paid to any one individual. In other words, such "income" includes mainly the sum total of profits, interest paid, taxes paid, rent, depreciation, depletion, and a few minor cost factors. On the other hand, corporations can claim a credit for the cost of labor, except for salaries above \$3,000. Such a labor credit will reduce the gross labor-differential tax and if the credit exceeds the tax the taxpayer will be entitled to an equivalent bounty. In a statement to the press Senator O'Mahoney said that it is the purpose of this measure "to provide work for the millions who are now without it."

The labor-differential tax: In the following analysis of the proposal it is assumed that the rate of the labor-differential tax will be 10 percent and tax credits and tax premiums of such an extent that actually all revenue collected by the tax will be disbursed as bounties.

1. Technical innovations may have two effects on the labor market. They may either lead to labor displacement if machines are installed for doing work formerly done by hand or they may increase the demand for labor to produce new machines and to satisfy consumer demand stimulated by new or cheaper products. This latter effect is possible, however, only if the industry increases its total capacity by new investments. A technical innovation leads to technological unemployment if the labor-displacing effect is greater, at least for a certain period, than the increased labor demand resulting from technical progress. In order to discover the effect of the labor-differential tax on technological unemployment, it is necessary to analyze its effects on technical innovation, on the one hand, and on industrial expansion, on the other.

2. The tax as proposed applies to all corporations whether or not they introduce labor-saving devices, but it affects the cost calculations of corporations which consider the introduction of such technical innovations. If a corporation is considering the introduction of a labor-saving machine it compares the cost of the machine

and its annual burden (interest, depreciation and obsolescence) with the wages which will be saved. The labor-differential tax would increase the cost of the machine by 10 percent, and would decrease the saving on wages by 6 to 8 percent of the payroll, because of the tax credit. Let us assume that a corporation could, by introducing a machine, produce a certain product at a cost of 84.5 while the cost of producing it by labor is 100. The introduction of the labor-differential tax at the rates suggested above would raise the annual cost of using the machine to 93.0, while the corresponding costs of production by labor would be reduced by the credit to 93.0. The incentive for introducing the labor-saving device would disappear. The actual cost differentials which lead to the adoption of a new technical method are generally much larger than is assumed in this example.

In addition, factors other than the bare cost calculation often enter into the decision. The desire of engineers to employ the most perfect technical device sometimes outweighs pecuniary considerations. Uncertainty about future wage developments and worry about possible labor trouble may often enhance the desire to employ labor-saving devices. On the other hand, the machine cannot be dismissed in a depression and results in diminished flexibility. The disadvantage of greater rigidity and higher overhead costs often outweighs a cost differential of only 15 percent. Such rates, therefore, would curb the introduction of important labor-saving devices only to a limited extent. To achieve this purpose generally, much higher rates would be necessary. A tax rate of 10 and a wage premium of 7 percent must be regarded as the very maximum for a tax which is imposed on all corporations and not only on the introduction of labor-saving devices. The curb on technical innovations therefore cannot be very great.²⁷

The tax, however, affects not only the introduction of labor-saving machinery but also the expansion of industries on the basis

²⁷ Mr. Karsten (cited above) expected much lower tax and bounty rates to suffice in bringing about reemployment on a large scale. He estimated that a tax of 3.2 percent and a bounty of 1.3 percent would result in a decline in real labor costs of 4.4 percent, and in an increase of five million in private employment (p. 116).

of present technical methods. Whenever a corporation calculates the capital costs of expansion it must consider that thereby it increases the basis of this tax (although in this case it does not diminish the basis for the tax credit). The labor-differential tax thus has the same effect as a corresponding increase in the interest rates. It can be assumed that industries calculate much more closely in deciding on normal expansion than on the introduction of a labor-saving device. It is therefore quite possible that the tax might be more effective in curbing industrial expansion than in slowing down technical innovations. In any case, it cannot be assumed that this measure is an effective instrument for preventing technological unemployment. An efficient attack on the problem of technological unemployment should either directly regulate the introduction of labor-saving devices (which would be extremely difficult without far-reaching regimentation) or stimulate industrial expansion by increasing demand, which is the aim of many other recovery measures. This bill, however, would result in curbing the application of labor-saving devices and retarding industrial expansion, and thereby would partly defeat its own purpose.

3. How effective would be a premium paid to corporations having high labor costs in relation to capital costs? Can corporations be expected to hire more labor in order to increase the tax credit or become eligible for a tax bounty?²⁸ Experience with subsidies paid for increasing employment indicates that employment in corporations depends on market conditions and that subsidies do not induce enterprises to produce more if they have not already seen an upturn in the demand for their products. A subsidy which amounts to a maximum of 7 percent of the payroll cannot by itself have any marked effect.

At best the measure may curb the expansion in capital-intensive industries and stimulate development in labor-intensive industries through a moderate change in relative prices. A tax on the labor-

²⁸ Here again it must be emphasized that the premium is granted to all corporations with a payroll which is relatively high in their total costs, not only to those increasing employment and payrolls.

differential (which is substantially the "value added" minus payrolls) could be recommended as an offset to the undesirable effects of payroll taxes, equalizing the burden imposed on firms with a capital-intensive and a labor-intensive type of production.²⁹ Such a measure would eliminate the incentive to employ labor-saving devices and the advantages granted to capital-intensive industries, but it cannot be regarded as a means for achieving full employment.

Uses and Limits of Taxation in Employment Policy

By tax policy and by spending of the tax yield the government can transform profits and incomes of the upper brackets into consumer purchasing power, which may help in the adjustment of the economic system. Such a policy is effective within limits. It cannot solve the problems of adjusting our economy, but the economy probably cannot be adjusted without such a tax policy.

For the adjustment of cyclical fluctuations a flexible tax policy should supplement a flexible spending policy. For a program of mobilization of all productive forces for the defense effort a flexible tax policy is a necessity. Such a policy requires the development of legislative and administrative techniques which need further exploration.

Incentive taxation may sometimes be useful in stimulating consumer demand and investments or in influencing the "marginal" decisions of entrepreneurs, but it cannot be regarded as a very effective general instrument for promoting full employment. The main usefulness of tax policy in a program of economic adjustment lies in the fact that taxation can be instrumental in directing the flow of purchasing power, and not so much in its punitive or incentive effect on the behavior of individuals.

²⁹ See footnote 7 above.

WAR AND PEACE ECONOMICS OF AVIATION

BY KURT LACHMANN

SINCE ancient times the means of transportation have shaped warfare and, reciprocally, wars have influenced the means of transportation. Since the movement of men and material depends upon transportation, the art of warfare demands the destruction of the enemy's lines of communication. The present war is no exception to these rules. It may stress the importance of transportation even more than former conflicts. The Franco-German War of 1870-71 made the railways an instrument of military strategy. The first World War replaced the horse by the motor: it introduced caterpillar traction and decided the superiority of heavier-than-air craft. The Nazi victories of the second World War have been won by the modernized combination of airplanes and caterpillar tanks. The history of both weapons could be written as an account of technical progress or, from another angle, as the epic of the stubbornness of the military mind.

It may be no exaggeration to say that Germany's advantage has consisted in the fact that a revolution without principles had placed a successful war pilot in unrestricted charge of the industrial and military preparation of the air arm. No figures have ever been published about the German aircraft expenditures, but it is safe to assume that a considerable part of the 90 billion marks which, according to Hitler, the Nazis have spent on armaments has gone into the building of the widely scattered aircraft industry, its extensive laboratories and the training of its personnel.

The planning of the Nazi aircraft program was favored by the same fact which usually favors the aggressor: knowing when he intends to strike he can lay out his plans accordingly, whereas the strictly defensive nation has to submit to the unknown decision of the aggressor. This advantage of possessing the initiative is more

pronounced in regard to air warfare than in any other direction, for no other instrument of war so far in use has had a similar rate of obsolescence. The great riddle for the French, for instance, was the date at which they should turn from quality production of experimental planes to quantity production. The difficulties and risks in taking a decision led the French, in their unresolute state of mind, to the easiest course of postponing the painful decision even after war had been declared. The wrong strategical judgment of military leaders like Marshal Pétain and General Weygand¹ concerning the future role of the air arm contributed decisively to the fatal inaction.

The Nazis, on the other hand, had the advantage of knowing that they would use force and when they would use it. Therefore they were able to fix the exact date at which to switch from experimenting with the building of test planes to the serial production of the most advanced models. They selected five types, the heavy bomber Heinkel 111, the lighter bomber and reconnaissance planes Dornier 17 and Dornier 215, the dive bomber Junkers 87 and the pursuit ship Messerschmitt 109. These were put to mass production without further changes. A sixth type, the pursuit plane Heinkel 113, was added later. After one year of war they brought out five new series of planes.² The great investment of building a fleet of perhaps 20,000 planes at a cost of around 2 billion dollars (a very rough estimate) would have been lost entirely if the fleet had not been used at the time of its completion. In the space of one or two years an enemy airfleet of newer models could have made it obsolete.

Thus the obsolescence rate of aircraft determines the time table of an aggressive power within a very short margin. Any future peace settlement based on a balance of power will have to take account of this fact. If peace should be dictated after an overwhelming victory, the victor, it can be assumed, will see to the

¹ See his lecture before the Royal Institute of International Affairs on May 16, 1939, published in English under the title, "How France is Defended," in *International Affairs*, vol. 18, no. 4 (July-August 1939).

² *New York Times*, September 10, 1940.

complete destruction of the aircraft production facilities of the vanquished, and will monopolize for himself air traffic and plane production throughout his sphere of power. Even today we hear from Paris and Vichy that subjugated France is to become a nation of peasants.

It may be argued that the Treaty of Versailles had prohibited the building of military aircraft in Germany and that, nevertheless, Hitler succeeded in conquering France with just that weapon. This, however, proves nothing except the old truth that rights become worthless if they are not defended and enforced. With their successive abrogations of the Treaty of Versailles the Nazis, within something like six years, built the strongest airforce in the world and a production capacity which is variously estimated at 1,800 to 3,300 planes a month.³

Despite the totalitarian trend the German airplane factories were left in private ownership. It may be only a coincidence that Hermann Göring acquired, in 1933, a large interest in the Bayrische Motorenwerke, leading air engine producer, from the Italian-Viennese financier Castiglione. Yet it would be an error to ascribe the merit of this tremendous expansion to private industry; it became possible only through the complete regimentation of all productive forces directed toward the single goal, armament. Under this scheme military needs took precedence over all other needs and strict priorities were enforced in favor of the essential armament industries. The allocation of labor and material among the competing demands of the three branches of the fighting forces was decided by the leader of the second Four-Year Plan, the aviator Göring.

³ New York *Times*, March 14, 1940. Major Al Williams wrote in the New York *World Telegram* of May 7, 1940, that under emergency pressure Germany can produce 3,300 planes a month. T. P. Wright, senior engineer of the Curtiss Wright Corporation, declared in the April 1940 issue of *Aviation* magazine that at the beginning of 1940 Germany was actually producing at the rate of 1,600 planes a month. A London dispatch by James MacDonald in the New York *Times* of July 28, 1940, reports the English estimate of the actual German output as 1,800 a month, the estimate being based on factory space in use and on an employment of about half a million in the aircraft industry; the German first line strength was placed at 18,000 planes.

The French airfleet had been considered the strongest in western Europe not farther back than in 1935. This was before German mass production got started. The French failure cannot be ascribed solely to the nationalization of the aircraft industry under the government of the Front Populaire, as has become fashionable in some quarters. Certainly there was a considerable slowing down of production with the sit-down strikes and the five-day week, but the decisive fact remains that mass production was never started in France, for reasons which were mentioned above. Thus French production probably never surpassed 275 planes monthly.

The British too could not make up their minds in time of peace to go into mass production; yet they faced the problem more realistically by creating the so-called shadow factories which were to be put into operation after the outbreak of hostilities. But there seem to have occurred serious delays, either through technical failures or through vacillations on the part of the Chamberlain government. The latter reason certainly accounted for the postponement of the ordering of planes from the United States. According to a detailed statement, published in the *New York Times* of June 28, 1940, the British Purchasing Commission in the United States placed no orders at all for combat planes between the start of the war and the end of January 1940, though Great Britain had ordered 1,183 planes (of which, however, 738 were trainers) during the eighteen months before the war. The shadow-factory system has been successful, according to T. P. Wright, where it has been carried through with full control of the parent company, but it has failed where it approximated a license arrangement.⁴ British production was estimated at 1,200 planes a month in the first months of the war; in March 1940 it had dropped to 800⁵ because two types of planes which had been produced in quantities had proved insufficient and had to be withdrawn from production.⁶ Major Al Williams remarked that this was the penalty for

⁴ T. P. Wright, "50,000 Planes a Year" in *Aviation*, vol. 39, no. 7 (July 1940).

⁵ *New York Times*, March 14, 1940.

⁶ Major Al Williams in the *New York World Telegram*, May 18 and 24, 1940.

incomplete research work. The Germans, he added, were in 1938 employing 7,500 full-time research scientists to determine types of planes; England employed about 400, France 175 and the United States about 250.

Under the direction of Winston Churchill and Lord Beaverbrook British production has been speeded up considerably. Churchill declared in his speech to the House of Commons on August 20, 1940, "Our new production already largely exceeds his" (the enemy's). Since British sources, as noted above, simultaneously estimated the German production at 1,800 monthly, this would suggest a British rate of more than 1,800. H. W. Baldwin, however, reported that in July British production had dropped to, or almost to, 1,200 planes, because of the interference by air raids.⁷ The explanation may be that Churchill had added the production of the Dominions. According to the Canadian Minister of Munitions, C. D. Howe, Canada's airplane output reached 500 in July,⁸ and Australia and the Union of South Africa seem to have developed at least some stages of the aircraft industry. Though the industrial effort of the Dominions had been held back by the Chamberlain government, in order to avoid disagreeable competition after the war,⁹ the new drive by Winston Churchill and Lord Beaverbrook will undoubtedly lead to a considerable expansion of the Dominions' aircraft industry.

Any reliable data there may be about Russian production have not come to my notice. That it ranks high among those of the great nations is generally accepted, and is supported by the report of an American expert who declared that in 1939 a single Russian plant was equipped for an annual production of 10,000 Wright cyclone engines of 1,200 horsepower.¹⁰

The United States aircraft industry is now in the process of rapid expansion. The total output of all types amounted to 2,000

⁷ New York Times, July 31, 1940.

⁸ New York Times, July 30, 1940.

⁹ Albert Viton, "Is Britain Doomed?" in the *Nation*, vol. 150, no. 26 (June 29, 1940).

¹⁰ Interview with Arthur Nutt, vice president of engineering for the Wright Aeronautical Corporation, in New York Times, March 17, 1940.

planes up to the first World War; 18,000 were produced during the period 1914-20, and since then 26,000.¹¹ In 1930 the industry's output was worth about 30 million dollars; in 1939 it had risen to 255 million, and in 1940 it is expected to be around 500 million. The production of civil aircraft in 1939 amounted to 3,715 planes, of which 3,037 were small craft with engines of 70 horsepower or less.¹² The production of military aircraft remained in the experimental stage until larger orders of the Allies were placed in the early months of this year. Actual production of combat planes in June 1940 was placed by the Aeronautical Chamber of Commerce at 500 and the yearly capacity at 10,000 to 12,000. In July monthly production was estimated by the *New York Times* (July 27) at 700 to 800 military planes. As to the future acceleration of mass production, the Aeronautical Chamber of Commerce has put the maximum production of 1941 at 15,000 to 20,000 military planes of all types, and believes it will take three to four years to achieve an annual production of 50,000. T. P. Wright¹³ declares that an annual production of 24,000 military planes can be achieved in two and a half years, a rate of 36,000 in four years, and a rate of 50,000 by July 1945; the total manufacturing personnel would have to be raised from the present 100,000 to 680,000. A publicity report of the National Defense Advisory Commission of September 2, 1940, spoke of a present monthly production of 1,000 planes which will be increased to 2,000 early next year and to 3,000 by the end of 1941. Comparison with the figures above leads to the assumption that in this report military and commercial plane production have been added together.

The combined capacity of all the major nations (except Russia) which may be reached by 1942-43 appears then to be well above 100,000 planes a year. What does this mean in terms of the post-war economy?

First of all, it should be observed that production capacity has

¹¹ Data of the Aeronautical Chamber of Commerce, reported by the *New York Times*, June 2, 1940.

¹² *Civil Aeronautics Journal*, vol. 1, no. 5 (March 1, 1940).

¹³ In *Aviation* (July 1940), cited above.

a different value in primary production from that which it has in the production of finished goods subject to quick technical change. The standard products of the steel or copper industry remain more or less the same, and their rates of depreciation and obsolescence are low; therefore in these industries there is the possibility that an expanded capacity can be utilized whenever the demand arises. In the aircraft industry, however, with its fast changing types, the value of the equipment becomes obsolete in a short period.

A new type of plane or motor necessitates completely new machinery. What remains of a plant, after the production of one type is finished, is its goodwill, its technical knowledge and the skill of its workers, its buildings and testing apparatus, a small part of its tools, and its cash reserves. If a plant reaches such a degree of perfection that it can sell a large series of one type, then a fuller use of its equipment may be expected, and accordingly a decrease in unit costs somewhat similar to what resulted in the manufacture of the automobile. The longer the war lasts, the higher the chance that a nearly perfect type of long-range bomber or transport plane may be achieved. But even this economy of production can apply only to the most advanced section of the whole industry.

Yet these are not the only facts to be considered. The war is increasing not only the number and size of plants but also the number of aircraft engineers, mechanics and pilots. The ground organizations, the airports and instruments, are multiplying. Special air ministries or air bureaucracies are being created. In all great nations a formidable new pressure group is arising, endowed with martial glory and a fascinating appeal to youth. In colleges and in barracks the new generation is being trained to become air-minded. Magazines and movies are doing their part in heroizing the pilot. Already the airmen are forming a kind of aristocracy among the armies. The limelight of publicity is on them. In Germany the air corps has succeeded to the exalted tradition of the cavalry; Marshal Göring has provided it with special honors and

selected his pilot officers partly from the noble and wealthy classes. The British Tory government tried to preserve the air service exclusively for the upper classes until the necessities of warfare brought about the dismissal of Lord Swinton as air minister and the admittance of new blood. During the peaceful twenties the American propensity to hero worship found its object in Lindbergh, and even the egalitarian Soviets have produced their air heroes of the Arctic.

Internal revolts and revolutions depend today upon airmen as supporters or leaders. The whole technique of the coup d'état, as developed by Trotsky, is bound to be changed by the use of aircraft. Ramon Franco, the ocean flyer, played a leading role in the dethronement of the Spanish monarch, and Hermann Göring, the World War ace, became Number 2 in the destruction of the German republic and Number 1 in the preparation for the destruction of Europe. D'Annunzio, the aesthete of brute force, sang the glory of the aviator; his disciple Mussolini took to flying at an advanced age and sent his son and son-in-law into dog-fights over foreign countries. Only old-fashioned conquerors like Admiral Horthy still ride to triumph on a white horse; the streamlined Caesar descends from the sky. The new strategy of the blitzkrieg and of the air defense is placing the aviators in a similar position in relation to the mass armies as the mediaeval knight occupied in relation to the footmen. No more emphatic acknowledgment of this turn has come forth than the memorable remark made by a former navy man: "Never in the field of human conflict was so much owed by so many to so few."¹⁴ The praise of a statesman and—the analysis of a sociologist! It would be tempting to pursue this line of thought and to inquire into the special mental type of the aviator, that mixture of daring and precision, of fight, fatalism and pragmatism, of romantic ambition and the modern creed of efficiency.

The postwar world, whatever it may be, will inherit the apparatus and the men of the air. If war remains the dominant note

¹⁴ Winston Churchill in his speech to the House of Commons on August 20, 1940.

their employment will not be in doubt. If human society can turn again to peaceful aims, these energies and investments will have to look for other outlets. In any case, their driving force can be visualized as one of the main features of the time to come. In a peaceful society of rational organization the further development of aircraft would depend upon the cost of production and the market for the product.

The cost per unit is closely related to the problem of serial production, and this in turn is dependent upon the rate of technical progress or obsolescence. The extraordinary push which the armament race is giving to research and technical progress may have led, by the end of the war, to a degree of near-perfection that will allow for the temporary freezing of the most advanced types. Then arrangements could be made similar to those existing in the automobile industry which would permit the combination of serial production and gradual advance. The manufacture of wings and fuselages out of molded plastics is still in the experimental stage, but with a further advance in the quality of plastics the all-plastic plane, allowing a very substantial saving in labor costs, seems to be within reach.

The market of the commercial airplane consists today of the airlines and the small but expanding group of amateurs. To what extent does the price of the plane and motor enter into the operating costs of the airlines? An American author puts the proportion at 15 per cent of the total operating costs.¹⁵ His calculation is based on the operation of the passenger liners Douglas DC-3 and DST; the average costs of operation, including ground and overhead expenses, are distributed approximately among the various components. A Canadian gives an exemplary scheme of the cost distribution of commercial air transportation in Canada per productive hour, and arrives at a depreciation rate amounting to 23.1 per cent.¹⁶

A statistical study of the operating costs of transcontinental and

¹⁵ W. M. Barclay Harding, *The Aviation Industry* (New York 1937) p. 51.

¹⁶ N. T. Macleod, *Air Transportation Costing* (London 1937) Table E.

transoceanic airlines in 1937-38 was made by a German author, on the assumption of a biweekly flight with planes of a live-load capacity of two metric tons; on the transcontinental lines the depreciation of plane and motor amounted to 18.5 per cent of total operating costs, and on the transoceanic lines it came to 27.3 per cent.¹⁷

If the price of a plane were cut in half by serial production the reduction in the total operating costs of commercial airlines—figuring a middle rate of 20 per cent depreciation—would be 10 per cent. The reduction in plane insurance would bring costs down perhaps another per cent. With traffic and safety increasing, the average total insurance rate, amounting to about 7.5 per cent of total operating costs, would probably also be reduced. One important step in this direction has been taken recently by the Equitable Life Assurance Society, in putting the air risk of fare-paying passengers on regular air routes in the same position as other accident risks affecting life.¹⁸ Other savings might be made in the cost of the ground equipment, inasmuch as states and communities may be expected to contribute increasingly to the expansion of air transportation.

Yet there are certain limitations to the expansion of the commercial service. They are usually measured by the number of passengers carried by Pullman cars. It has been figured out that 4,000 planes on the airlines could carry the entire Pullman passenger trade, 500 additional planes the entire railway express freight and 30,000 or 40,000 more planes the whole first-class mail plus much more cargo.¹⁹ Captain E. V. Rickenbacker has estimated that 100,000 planes would be needed to carry all first-class mail by air for distances over 100 miles.²⁰ Since the average life of a commer-

¹⁷ Carl Pirath, *Der Weltluftverkehr*, vol. 12 of the *Forschungsergebnisse des Verkehrswissenschaftlichen Instituts für Luftfahrt an der Technischen Hochschule Stuttgart* (Berlin 1938) pp. 70-71.

¹⁸ *New York Times*, July 27, 1940.

¹⁹ Calculations by Grover Loening as reported by Arthur Krock in the *New York Times*, March 29, 1940.

²⁰ *New York Times*, May 19, 1940.

cial plane in first line service is five years, the usual replacements for a fleet of 45,000 planes would require 9,000 new ships annually, for a fleet of 100,000 planes 20,000 annually. To this should be added the demand for spare parts and reserve engines: the sale of spare parts averaged approximately 26.6 per cent of the total sales of engines and parts made by the American aircraft engine industry during the period 1928-36.²¹ Furthermore, it is possible that a medium-distance passenger traffic may be developed, thus decentralizing the big cities, if roof-top landing fields and a perfected type of the autogiro can be put to use.

There remains the export market. With a little imagination one can foresee many new applications of the airplane in the undeveloped areas of the world. Such regions may well skip the eras of the railway and the motor highway and start their modern transportation system in the air. There are already some signs of such a development in Central and South America, where the highest mountain ranges obstruct traffic by land. W. E. D. Stokes, Jr., on the basis of experience with air transportation of ores in Honduras, explained to the American Institute of Mining and Metallurgical Engineers that a modern bomber, traveling 300 miles an hour, could be used to carry 3-ton loads between points 1,200 miles apart, making two round trips a day, at a cost of less than five cents a ton-mile, or half the cost of carrying similar loads by 15-ton trucks. The spanning of the oceans by wings carrying mail and passengers has already progressed so rapidly that it has become a commonplace.

From a glance at the commercial airline maps of Europe and the United States it can easily be seen how important international cooperation is with regard to the efficiency and the cost of air transportation. Before the present war Europe had a crisscross of competing airlines, short distanced and shortsighted. A French author²² showed in 1935 that the United States airlines covered

²¹ W. M. Barclay Harding, *op. cit.*, p. 28.

²² A. Verduran, "Pourquoi les transports aériens coutent-ils trois fois moins cher aux États Unis qu'en Europe?" in *L'Aéronautique*, no. 197 (October 1935) pp. 258 ff.

79 million kilometers annually with 580 planes while the European lines flew 30 million kilometers with 623 planes; in the United States operating costs amounted to 4.85 French francs per kilometer as compared with an average cost of 17.80 francs in Europe.

Nationalistic barriers are as irksome in the air as on land. But in either sphere their removal presupposes liberation from the fear of aggression. Without international order the achievements of technology are bound to become the means of anarchic destruction: air power has shown sufficiently what it can do to peaceful, unsuspecting people. But when the anarchic forces are destroyed, or at least shackled by superior cooperating forces, then aircraft stimulated by war will become a major stimulus of a more abundant peace.

(New School for Social Research)

AUSTRIA: GUILT AND VIRTUE—I¹

BY ERNST KARL WINTER

The Enlightened Monarchy

MODERN legislation in Austria came into being at the same time as modern constitutionalism in America. When the Declaration of Independence was drafted, Austria, with a population of nearly 25 million, was the most varied of the European empires.² The era of Maria Theresa, Joseph II, Leopold II and Kaunitz—who administered Austrian foreign policy under all three rulers—is the beginning of modern Austria³ as the era of Washington, Jefferson and Hamilton is the dawn of America.

When America's independence was formally established, Joseph had already enacted his most far-reaching reforms (1781-83): the Subject Patent for the protection of the peasantry against feudalism; the Emancipation Patent, abolishing personal bondage (*Leibeigenschaft*) and reestablishing personal liberty, free marriage, free movement and free choice of occupation; the Robot Patent, substituting the optional payment of a money tax for the corvée; the Toleration Patent, recognizing religious freedom for Protestant and Orthodox; the Jewish Patent, abolishing the yellow badge and

¹ This article, which will be concluded in the next issue, is a complement to the author's article on "The Rise and Fall of Austrian Labor" in *Social Research*, vol. 6, no. 3 (September 1939) pp. 316-40. It also includes answers to most of the objections to the article made by Charles A. Gulick, Jr., and Alexander Gerschenkron in "Errors and Traditions," *Social Research*, vol. 7, no. 1 (February 1940) pp. 45-60.

² The Austrian empire in 1780 included: the Austrian hereditary countries—Lower Austria (1.1 million), Upper Austria (0.6), Styria (0.8), Carinthia (0.3), Carniola (0.4), Tyrol and Vorarlberg (0.7), Gorizia-Gradisca and Trieste (0.2); the kingdom of Bohemia (2.7) with Moravia and Silesia (1.5); the kingdom of Hungary with Croatia-Slavonia (7.1), the Military Frontier (0.7) and Transylvania (1.4); the Austrian Netherlands with Luxembourg (2.2); Lombardy, including the duchies of Milan and Mantua (1.4); Further Austria, including Breisgau and Burgau (0.4) and as the most recent acquisition the kingdom of Galicia-Lodomeria with Bukovina (3.3).

³ J. Alexander Mahan, *Maria Theresa of Austria* (New York 1932); Constance Lily Morris, *Maria Theresa, The Last Conservative* (New York 1937); S. K. Padover, *The Revolutionary Emperor, Joseph the Second* (London 1934).

establishing equality in commerce, banking and industry; the Marriage Patent, declaring marriage a civil contract; degrees introducing compulsory public education, abolishing capital punishment and torture, establishing the liberty of the press; the anti-ecclesiastical legislation,⁴ including the secularization of 700 contemplative monasteries with 40,000 monks and nuns, the suppression of pilgrimages, popular devotions and the relic and picture cult, the establishment of state control of hierarchy and clergy, the Religion Fund, general seminars and the parish organization; and finally the systematic destruction of the estates and the introduction of centralized administration. The radicalism of Joseph's social legislation is a prerevolutionary phenomenon without analogy, and achieved for Austria, without civil war, even more than was brought about in England, America and France by revolution.

Some of the Austrian countries experienced both the Austrian reform and the French revolution. In Lombardy the Austrian administration had given rise to a period of regeneration. From the Lombard intellectuals the idea of enlightenment spread out. "Lombardy breathed again under the Austrians," writes an Italian historian.⁵ "The period of Maria Theresa has remained the golden age in the memory of the Lombards. There were few taxes, improved agriculture, regulated administration, flourishing philanthropic institutions, useful public works, an embellished Milan, profound peace, quiet living, good eating, no military service. There was no sorrow because of the dependence upon a Vienna which initiated reforms and seconded the native philosophers, who were appointed to the highest public functions. The idea of the fatherland was limited to the shadow of one's own steeple, the idea of nationality had not emerged in the consciousness of the people, nor did it exist except as a germ in the minds of the innovators. The Lombards were under Austrian rule, but it was the Lombards who improved their mode of life."

Only Tuscany, under Joseph's younger brother Leopold, was

⁴ Sister Mary Clare Goodwin, *The Papal Conflict with Josephinism* (New York 1938).

⁵ Carlo Tivaroni, *L'Italia prima della rivoluzione francese* (Turin 1888).

more advanced in social reform.⁶ Here Leopold built up the most modern of the prerevolutionary European states, anticipating but also far surpassing his brother's reforms. Leopold's lasting idea was that of complementarity: "the government should not mix into affairs which private people may perform better." In one of his first decrees he says: "It is not the function of the supreme authority to regulate private fields and to limit or extend them according to its own arbitrariness. Such interference would only disturb and ruin them, and would never belong to its own task of facilitating and developing the public interests." Leopold carried through far-reaching reforms (1767-86): the establishment of free trade in grain, the abolition of the *appalto*, the abolition of the guilds and the establishment of a central chamber of commerce, the reorganization of local government, the abolition of rural servitude, trade agreements with barbarian countries like Morocco, the disbandment of the army and navy, the division of the latifundia into small peasant holdings, the reform of the criminal law, the abolition of capital punishment and torture.

Leopold's greatest achievement was the reorganization of local government, deliberately aiming at modern representation. This accomplishment clearly distinguishes Leopold's enlightened constitutionalism from Joseph's enlightened despotism. One of his collaborators⁷ later revealed the fact that as early as 1779 Leopold had in view the completion of his reforms with the promulgation of a Tuscan constitution. His understanding of modern constitutionalism was also demonstrated by his later activity in Lombardy,⁸ where he tried to reorganize the estates as the "permanent representation of the society of the state," and by similar steps in other countries. The modern idea of representation was also present in his ecclesiastical policy, supported by Bishop Scipione de' Ricci,

⁶ Antonio Zobi, *Storia civile della Toscana*, vol. 2 (Florence 1850); Mario Aglietti, *La costituzione per la Toscana del Granduca Pietro Leopoldo*, *La Rassegna Nazionale* (Florence 1908) pp. 273-95; Antonio Anzilotti, *Decentramento amministrativo e riforma municipale in Toscana sotto Pietro Leopoldo* (Florence 1910).

⁷ Francesco Maria Gianni, *Scritti di pubblica economia*, vol. 1 (Florence 1848).

⁸ Francesco Valsecchi, *L'assolutismo illuminato in Austria e in Lombardia*, vol. 2 (Bologna 1934) p. 261.

who in 1786 held the famous Synod of Pistoia where more than 200 secular and regular priests, including 160 parish pastors, democratically voted far-reaching ecclesiastical reforms (later condemned by the papal bull *Auctorem fidei*, 1794). This is the most interesting experiment in ecclesiastical democracy in any Catholic country.

In Belgium,⁹ however, enlightened despotism met its most serious defeat, even though its economic policy was very useful for that country. Joseph tried to reopen the Scheldt river, which earlier treaties had closed, but he failed (1781-85). Not until 1865 was free trade on the Scheldt restored and Antwerp then became Belgium's first harbor. Joseph also planned to organize international trade through Ostend. When the United States was formally recognized, he immediately considered the possibility of having trade relations with America. For this purpose the first Austrian ship sailed from Trieste to Philadelphia, the first imperial consul, a Belgian, was installed there and the imperial ambassador at Paris was sent to John Adams in the hope that Benjamin Franklin himself would visit Vienna to conclude an agreement.¹⁰ Joseph did not know of Adams' predilection for Frederick II, already expressed in 1779 before Congress, where he declared that "as Austria will be one of the last, so Prussia will be one of the first to acknowledge our independence."¹¹

In 1790 when Joseph introduced his reforms in Belgium, the Brabançon Revolt broke out. One of the most exciting phenomena of prerevolutionary history is this final overthrow of enlightened despotism, in spite of its social tendencies. "A general folly seems to have seized all people," Joseph said in his last days to the French ambassador. "Those of Brabant, for instance, are revolting because I have wished to give them that which your nation demands in a great crisis." But Joseph did not understand what it meant to the

⁹ Henri Pirenne, *Histoire de Belgique*, vols. 5-6 (Brussels 1921-26); L. Deplace, *Joseph II et la révolution brabançonne* (Brussels 1890); F. Magnette, *Joseph II et la liberté de l'Escaut* (Brussels 1896).

¹⁰ Hanns Schlitter, *Die Beziehungen Oesterreichs zu den Vereinigten Staaten, 1778-87* (Innsbruck 1885).

¹¹ John Adams on Frederick the Great in *More Books*, *The Bulletin of the Boston Library*, vol. 9 (1934) pp. 117-33.

people to carry through by laws what the enlightened despots did by decrees. In 1795 Belgium was annexed by France which carried through by force the reforms Joseph had attempted in vain.

Although the administrations of Joseph and Leopold were by far the most progressive in prerevolutionary Europe, Frederick II of Prussia¹² became the model ruler of the Enlightenment in the eyes of the Encyclopedists. It is true that Frederick too belongs in the category of enlightened despots. But Frederick's demon was war. Prussian tolerance had as its final goal the creation of a military machine. Frederick's reproach that Joseph was accustomed to take the second step before the first reveals the gulf between the two: Joseph, the radical idealist, and Frederick, the cautious realist who accepted only as much liberalism as was required by *raison d'état*. They represent two types of conservatism, *toto caelo* different. As Frederick was the enlightened heir of the Teutonic Knights, so Joseph was the reincarnation of Rudolph IV,¹³ who was at once the most splendid and most tragic figure in Austrian history. New epochs began with both Rudolph and Joseph. If in Joseph's case the new epoch had begun fifteen years earlier when he became Roman emperor but was without real power, or if his enlightened despotism had been more like Leopold's enlightened constitutionalism, or if Frederick had been an enlightened monarch of the Hapsburg type—then perhaps a new era in Europe might have been brought about without revolution.

The Conservative System

When Leopold succeeded his brother in 1790 he began the reformation of Austria in line with his experiences in Tuscany. The Belgian constitution was restored, seeming to the emperor a model for other countries. "It is good luck," he wrote, "if a country has estates and a constitution to which the people adhere. In such a country there are mutual obligations between ruler and people

¹² Werner Hegemann, *Frederick the Great* (London 1929); *Das Jugendbuch vom Grossen König* (Hellerau 1930); Nathan Ausubel, *Superman. The Life of Frederick the Great* (New York 1931).

¹³ See my book, *Rudolph IV von Oesterreich*, 2 vols. (Vienna 1934-36).

which can be modified only by mutual agreements." The Polish constitution, modeled on the English and introduced by Stanislaus Poniatowski in 1791, found in Leopold an ardent and prudent advocate. According to one of its authors, Count Ignace Potocki, the death of Leopold in 1792 sealed the fate of Poland. If Leopold had lived longer he might have achieved, through his outstanding moderation, a turn from the system of estates to one of modern representation throughout his entire empire.

When Francis II ascended the throne, Austria had to defend herself against the growing influences of the French revolution.¹⁴ Thus the regime of Francis became in many instances opposite to that of Joseph; they, nephew and uncle, represent the two wings of Austrian tradition. Nevertheless, there is continuity in their regimes. Joseph's basic reforms—toleration, peasant emancipation, state control of the church—were continued under Francis.

For more than twenty-five years the Austrian system was represented by the intimate collaboration of Francis and Metternich.¹⁵ The Metternich ideology remained alive in diverse variants under Francis Joseph, Bismarck, Disraeli and Leo XIII. There are indeed only a few phenomena of history which illustrate so clearly the structure of conservatism. No greater mistake can be made than to regard Metternich as an obscurant, as was long customary. On the contrary, he was a child of the eighteenth century, continuing the heritage of Kaunitz, admiring Leopold whom he compared with the greatest Medici, but criticizing Joseph because of his "obstinate despotism." Metternich consciously continued the pre-revolutionary tradition, but with such emphasis as he thought was required by his postrevolutionary task.

The Austrian system, shifting in 1804 from the empty dignity of the Roman empire to the reality of the Austrian empire, was internationally the organizing force of the continent. The Congress

¹⁴ Walter Consuelo Langsam, *Napoleonic Wars and German Nationalism in Austria* (New York 1930).

¹⁵ Heinrich Ritter von Srbik, *Metternich* (Munich 1925); Algernon Cecil, *Metternich* (London 1933); Helene Du Coudray, *Metternich* (London 1935); Frederick de Reichenberg, *Prince Metternich in Love and War* (London 1938).

of Vienna, the Holy Alliance (by which the sovereigns of the three conservative powers promised to regard themselves as fathers of their subjects and armies, and the Christian nations as one single family), the Quadruple Alliance (more reality than mysticism, visualizing the Quintuple Alliance as its consequence), the system of European congresses from Aachen to Verona—these were the steps which established the first modern system of European cooperation, based upon the equilibrium of the five great powers and making Vienna the arbiter of Europe, but Metternich the charioteer of the European quadriga. The stability of this international system was based upon a hierarchy of relations: the Austrian empire with its hegemony over both Germany and Italy, the cooperation of the two central European powers with Great Britain, of the four anti-revolutionary powers against France, and of the three eastern monarchies against the western democracies.

In all these relations the cooperation with England was the most important. After the organization of the anti-Napoleon coalitions, the conservative system was based upon the intimate cooperation between Metternich and Castlereagh, "the most European and least insular of all British foreign ministers." This cooperation was eventually destroyed, or at least crippled, by the antagonism between Metternich and the Whigs Canning and Palmerston, but it was again revived when the Tory Disraeli, proudly calling himself Metternich's pupil, superseded the Whigs. Austro-British cooperation disintegrated not so much because the Whigs favored the national and liberal movements which Metternich opposed, but because the world interests of the two liberal western European powers could not be reconciled with the primarily continental interests of central Europe. Metternich's weak point was his misconception of British world policy. This antagonism between worldwide and merely continental interests meant the end of the Quintuple Alliance and the creation of two European blocs, although the bitter consequences were not realized for three generations.

That Austria stood for legitimacy and intervention, but against liberalism and nationalism, did not hinder her from being elastic

enough to assimilate whatever positive trend of the age proved to be valid. The examples of Belgium and Greece in 1830 show clearly how the pentarchy was able to perform what Metternich called the "christening" of the natural principle of nationality and popular sovereignty, legalizing it by the European areopagus. But this was only the expression of his doctrine that conservatism is "supervised progress" and "constructive reform," excluding only "experiments" and "concessions." It was because of this ideology that he called himself a "socialist," devoted to the idea of social order. He understood the term as emphasizing the priority of social reconstruction as compared with merely political operations, and as proclaiming the primacy of European policy over purely national goals. As a consequence, the prerevolutionary system was not simply "reactionary." Metternich himself advocated the idea of general estates for all Austrian countries, and was moreover fully in favor of social legislation. There were also many other Austrian officials, high and low, who advocated reforms, and many drafts of social legislation. The very fact that the masses of peasantry could expect reforms constituted the basis for the cooperation between the imperial administration and the popular movements which enabled the monarchy to survive 1848.

Francis also had a constructive idea of society, although his was no reformist mind. He was personally responsible for some interesting social legislation strongly opposed by his own bureaucracy. His early idea, in tune with the romantic movement, was to check the expansion of industrialism by strengthening the economic independence of small holders. In 1802 there was a complete prohibition of new factories in Vienna and suburbs which lasted until 1811, when the system of industrial liberty was revived, a victory of the international situation over the emperor. But Francis later returned to the social ideas of his youth, and between 1832 and 1835 he initiated the first trade enquête and the first draft of a trade law. One of his final decrees was concerned with the promotion of industrial workers to economic independence. His was a primitive reaction against modern industrialism, but sixty years

later *Rerum novarum* took up his idea of "deproletarianization." One of the most astonishing results of the Austrian system is that some of its ideas have continued in the guise of papal doctrines: Leo XIII was consciously a pupil of Metternich. From this viewpoint it is only consistent that the social scheme elaborated by the popes was again adopted by Austrian conservatism when Dollfuss strove to model his country on the encyclical *Quadragesimo anno*.

Metternich was in favor of social ideas in line with those of the romantic school of political thought. He brought many romantic writers to Vienna: Gentz, the first German to advocate British constitutionalism, was his secretary for thirty years; Müller, Schlegel and Jarcke were in the Austrian service. All these theorists stood against the French revolution and against Adam Smith. They were all influenced by Edmund Burke (whom Gentz translated), by the French De Maistre and Bonald, by the Swiss K. L. Haller, who had also been in Austrian service. They tried to modernize conservatism, to learn from the French revolution, to combine tradition and progress. They stood for the family, authority, the paternal state, but for liberty as well. The idea of the emancipation of the proletariat has its deepest roots in the writings of Müller, Baader and Haller, who greatly influenced Marx in his earlier work.

That Vienna became the center of an intellectual movement at once conservative and progressive was due to two factors: to the atmosphere of Austrian civilization which had already produced the reforms of Joseph and to the religious renaissance which was in a double sense the consequence of Joseph's legislation, as a reaction against its anti-mysticism and as the fruit of its separation of church and state. This religious movement, to which most of the romantic writers were personally attached and by which both Francis and Metternich were influenced, centered around the unique personality of Clemens Maria Hofbauer, a Moravian who became the patron saint of Vienna and whose spiritual influence, as the re-founder of the Redemptorists, spread round the world and was of far-reaching importance for American Catholicism.

What the prerevolutionary Austrian system really meant can be

revealed only by reviewing the Austrian lands. The empire then had 30 million inhabitants and had gained three new countries on the Adriatic (Dalmatia, Istria and Venetia), but had lost the western provinces of Belgium and Further Austria. The outstanding example of the achievements and limitations of the prerevolutionary Austrian regime is its administration of the kingdom of Lombardy-Venetia.¹⁶ Modern Italian historians fully recognize the Austrian achievements, but a hundred years ago world opinion was passionately against Austria. Austria had indeed continued in Lombardy-Venetia the despotic, Germanizing and anti-clerical tendencies of Joseph's regime, making Catholicism too anti-Austrian. The high treason trials, although carried on before Austro-Italian judges, were advertised throughout Europe. But behind this struggle the positive achievements of the Austrian administration cannot be denied: the universities, compulsory public education, civil and criminal legislation (although without the jury courts of the Code Napoléon), correct administration and judicial practice, general representation in two central assemblies, provincial autonomy, municipal self-government, social policy, a silk industry aimed to surpass that of France, a weaving and spinning industry competing with that of England, the construction of roads, canals and bridges. The chamber of commerce at Milan became a center of economic activity. The first life-insurance company and the first savings bank in Italy were organized there. The child labor law of 1843 shows the social policy of the prerevolutionary system at its best. Nevertheless, Austria made only a few friends in Italy. One of these, Giuseppe Sacchi, the instigator of the child labor law, recognizes two achievements of the Austrian administration which made Lombardy-Venetia "the leading country of Italy": the network of roads and the system of compulsory public education. Nevertheless, as a prerevolutionary French paper said, Lombardy-Venetia had "embonpoint" economically but was treated like a "eunuch" politically.

Another field of colonial experimentation for Austria was the

¹⁶ Kent Roberts Greenfield, *Economics and Liberalism in the Risorgimento. A Study of Nationalism in Lombardy, 1814-48* (Baltimore 1934).

kingdom of Galicia-Lodomeria¹⁷ of the Polish heritage. Maria Theresa had not wanted it—with her sound instinct she had regarded the partition of Poland as a fateful crime—but Joseph had gladly cooperated with Russia and Prussia. When he visited the new province he wrote to his mother: "The peasant is an unfortunate being who has nothing but the human figure and physical life." For no other country was Joseph's legislation of greater importance. The emancipation of the peasantry and of the Jews had for Austria two social consequences of future importance: the eastern Jews found their way to western Europe primarily through Austria, and the Polish and Ruthenian peasants gravitated to Vienna where they were made free. Ten years ahead of Kosciuszko's reform, Joseph liberated the Galician peasants as human beings, giving them hope of economic and political liberation as well. When the Polish revolution broke out in 1846, the peasants stood by the government. With scythes and flails they stormed the castles, lynching their lords. The slogan of the Polish peasant leader, Jacob Szela, was: "God in heaven, the emperor at Vienna and I on my land." Massacres occurred. Many prerevolutionary officials like Count Francis Stadion, governor of Galicia, wanted immediate compulsory redemption of the feudal servitudes. Finally, while the revolution paralyzed the government in Vienna, Stadion enacted in Galicia the first complete liberation of the peasants, with state compensation of the lords. This first peasant emancipation followed plans of the prerevolutionary regime which had been delayed until the revolution forced their enactment. Thus Galicia became both the experimental field and the model for the Austrian legislation.

In 1848 the first Polish governor was installed in Galicia. In 1868 the last remnants of the Germanizing era were removed. From

¹⁷ R. Nisbet Bain, *The Last King of Poland and His Contemporaries* (New York 1909); Miecislaus Haiman, *The Fall of Poland in Contemporary American Opinion* (Chicago 1935); Léonard Chodzko, *Les massacres de Galicie et Krakovie confisquée par L'Autriche en 1846* (Paris 1861); Ludwig Mises, *Die Entwicklung des gutsherrlich-bäuerlichen Verhältnisses in Galizien 1772-1848* (Vienna 1902); Georges Bienaimé, *La Diète de Galicie. Ses tendances autonomiques* (Paris 1910); Roman Dyboski, "Poland" in *Encyclopaedia Britannica*, vol. 18.

then, writes Dyboski, "with Polish administration, schools and courts of law, Galicia became indeed almost an independent Polish state within Austria." In contrast with the persecution of the Poles in both Russia and Prussia, Galicia became "the Piedmont of the Polish national movement," the only country where Poles could think, speak and act Polish. When the new Poland emerged after the World War, Galicia, with seventy years of Polish administration behind her and with the only Polish bureaucracy, became the focal point of the Polish state machine. The Polish heritage, seized by Austria in her participation in one of the greatest crimes in history, had nevertheless been preserved very well.

In contrast to the traditional underestimation of the Metternich system, it has been necessary here to emphasize its virtue. Its guilt, consisting in the overestimation of legality and stability and the underestimation of liberal and national ideas, is obvious. Moreover, as it was the tragedy of the last generation in the eighteenth century that its predecessors did not surrender the reins at the right time, it became the tragedy of the first generation in the nineteenth century that it had no heirs. Ferdinand, the eldest son of Francis, though imbecile was nevertheless installed by Metternich as "successor of the entail" for the sake of formal legitimism. That period developed the "gerontocracy," that senile system for which nobody was really responsible but for which Metternich, although without real power in interior affairs, was the all-hated symbol.

Of all the authors in that period Heinrich Heine understood Metternich best. He explained in his *Französische Zustände* the final reason why some radicals, despising the "Prussian Jacobins," nevertheless had secret sympathy for Austrian conservatism: "Austria was always an open and honest foe who never denied her fight against liberalism. Metternich never ogled with loving eyes the goddess of liberty, he never played the demagogue with troubled, anxious heart, he never sang Arndt's songs while drinking white beer, he never practiced national gymnastics on the Hasenheide, he never played the pietist, nor did he ever weep with the prisoners of the fortresses while holding them on the chain. You always

knew what to expect of him. You knew that you had to beware of him and you did so. He was always a steady man, who neither deceived us by gracious looks nor enraged us by private malice. You knew that he was inspired neither by love nor by petty hatred, but that he acted grandly in the spirit of a system to which Austria has adhered for the last three centuries."

The Modern State

The two wings of Austrian tradition represented by Joseph and Francis, the enlightened monarchy and the conservative system, were continued during the age of Francis Joseph.¹⁸ The history of the reign of Francis Joseph is the history of the wavering between the two. What the Victorian age was for Great Britain, the age of Francis Joseph was for Austria. In 1848 the Austrian revolution, more for than against tradition, discontinued the policy of Metternich but continued that of Joseph. When the Magyar Lajos Kosuth spoke on the birthday of the revolution, he declared that "there was waiting for Francis Joseph the heritage of a splendid throne, built upon liberty." The Czech František Palacký refused an appointment to the German Parliament at Frankfurt-on-Main with the famous remark, "If the Austrian monarchy did not exist, it would have to be created in the interest of Europe and humanity." He added, "The preservation, integrity and strengthening of Austria is an important task not only of the Czech nation, but of Europe, of humanity and of civilization. Vienna, for the sake of Europe, must not decline to a provincial town."

The Austrian revolution came from above rather than from below. It began on Joseph's birthday in 1848, when the estates of Lower Austria discussed reforms in a meeting long planned, after which Metternich resigned. The first constitution copied the Bel-

¹⁸ Eugene Bagger, *Francis Joseph* (New York 1927); Joseph Redlich, *Emperor Francis Joseph of Austria* (London 1929); Karl Tschuppik, *The Reign of the Emperor Francis Joseph* (London 1930); Bertita Harding, *Golden Fleece. The Story of Franz Joseph and Elisabeth of Austria* (New York 1937) and *Imperial Twilight. The Story of Karl and Zita of Hungary* (New York 1940); Oskar Mitis, *The Life of Crown Prince Rudolph of Habsburg* (London 1930); Stephanie of Belgium, *I Was to Be Empress* (London 1937).

gian model. The only law enacted by the first Reichstag was the emancipation of the peasantry, and was modeled on the decree by which Stadion had carried through the liberation of the Galician peasants five months earlier. In 1848 the Magyars, Italians and Viennese revolted, but Austria survived the storm because of the support of the peasant masses of her nationalities.

After the liquidation of the revolution, the Schwarzenberg government, including Stadion, brought new ideas to realization under the authority of the new emperor, the youth Francis Joseph. The first step was the dissolution of the parliament at Kremsier, which had drafted the constitution and the fundamental articles, but had excluded Hungary. The new constitution, drafted by Stadion, was Francis Joseph's first coup d'état. The new government enacted decisive reforms—fruits of the prerevolutionary regime, the revolution and the postrevolutionary regime all together. This legislation for the entire empire, including Hungary, provided: jury trials for press offenses (later for crimes and political offenses also); municipal autonomy, including organization of "communities of higher order," circles and districts, and their democratization; three grades of courts, culminating in the creation of a supreme court; three grades of political administration—countries, circles and districts; educational reform in universities and high schools; and finally the technical realization of peasant emancipation, in accordance with Stadion's Galician decree. These reforms, enacted by an anti-revolutionary government which had dissolved the parliament, became the basis of Austrian legislation for the next seventy years. Thus the modern state in Austria was initiated by the revolution, but created by the postrevolutionary regime on the basis of prerevolutionary experience.

Yet this course was followed politically for only a short time. By the Sylvester Patent in 1851 the constitution was suspended and imperial absolutism proclaimed. It was Francis Joseph's second coup d'état, more personal and more fateful. The former liberal, Alexander Bach, became the right hand of the emperor. The Bach regime abandoned the revolution and cautiously resumed the Met-

ternich system, though without Metternich. Nevertheless, this imperial absolutism of Francis Joseph, who took his grandfather Francis as an ideal, accepted the fundamental achievements of the revolution, particularly the emancipation of the peasantry. Economically it was very liberal: chambers of commerce were founded throughout the empire, the first credit banks were organized, the transfer of the railroads to private operation began, the new trade law of 1859 accepted the liberal draft. All these measures were originally resented by Bismarck as combining the interests of clericalism and liberalism under the leadership of a "Jewish gang," but later he imitated Francis Joseph in both the economic and political fields.¹⁹ The centralizing administration of the Bach regime and its Germanizing tendencies also continued older traditions. Only the concordat with Rome in 1855 seemed to break with Joseph by carrying out the political testament of Francis and Metternich, and even it preserved many of Joseph's ideas now recognized by Rome. The concordat was the culmination of imperial absolutism. Four years later the defeat at Solferino brought about a return to constitutionalism, but the zigzag course still continued. The October Diploma in 1860 promulgated a federative constitution, while three months later the February Patent, in the guise of mere interpretation, turned to centralization.

The defeat at Sadowa in 1866 altered the very basis of the Austrian empire. The first consequence was the compromise between the crown and Hungary in 1867, which had to be accepted by the remaining "kingdoms and countries represented in the Reichsrat." The so-called Austro-Hungarian compromise was Francis Joseph's third and most far-reaching coup d'état. The liberal regime of 1867-79 again took up the policies of Joseph and the revolution, as it understood them. The Austro-German liberals—comprised for the most part of Germanized Czechs in the guise of Sudeten Germans but also, very fatefully for the future, of many German Jews—attempted to be as powerful as the Magyars. Under their

¹⁹ Chester Wells Clark, *Franz Joseph and Bismarck. The Diplomacy of Austria Before the War of 1866* (Cambridge 1934).

influence the concordat was first broken in 1867-68, but it was finally formally revoked because of the proclamation of papal infallibility by the Vatican Council in 1870. Francis Joseph then returned to the policies of his great-granduncle Joseph.

When the new dual state, the Austro-Hungarian monarchy, was consolidated internationally at the Congress of Berlin in 1878, and the Triple Alliance was concluded in 1882, a new phase of Austrian policy came into being. The Austro-German liberals, the *Herbstzeitlosen* (autumn crocuses) as Bismarck sneeringly called them, did not understand the Austrian turn to the southeast, agreed upon by the European mandate on Bosnia-Herzegovina and approved by all Austrian nations. Moreover, liberalism had proved unable to achieve social reform, from now on in the foreground. Thus the third era of Francis Joseph became the era of social policy, carried through by the Taaffe regime (1879-93) but backed by the first conservative movement from below. This modern legislation included three supplements to the trade law of 1859, concerning trade licenses, labor protection and trade corporations, and special laws concerning the trade inspectorate, accident and health insurance, miner insurance, health insurance associations, the mining corporations, instalment contracts and trade courts. The governmental bill concerning labor conciliation boards and labor committees, introduced in 1891-94, could not be enacted except in the special field of the mining corporations.

This era of social policy combined again tendencies of Joseph and of Metternich, but its culmination was the idea of constitutional monarchy as visualized by Leopold and Stadion. From the first social bill of the Taaffe cabinet to the sanction of universal suffrage in 1907, it was the consistent desire of the monarch and his main advisers to be included in that modern European evolution in which Great Britain and the Scandinavian countries were leading. More than the first or the second, this third stage of Francis Joseph's rule was his own. Unfortunately, it was a Sisyphean labor: because the national problem of the empire was not solved, the solution of the social problem in one of its halves was in vain.

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Mordecai Ezekiel, economic adviser to the Department of Agriculture, has, through his new book, *Jobs For All*, and through an earlier publication, *\$2500 A Year*, made the greatest contribution in recent years to the emergence of a "plan for planning." Ezekiel's point of departure is practical. He is interested in showing how agricultural and industrial activities can be expanded to full employment of all resources. The way lies, he feels, in a plan for increased output, drawn

¹ Eduard Heimann, in his brilliant and comprehensive study of "Literature on the Theory of a Socialist Economy" in *Social Research*, vol. 6, no. 1 (February 1939), has discussed some of the problems and books with which this review is concerned. The overlapping seems unavoidable in view of the close relationship between socialism and planning. Although there are, naturally, differences in approach and in delimitation of subject matter, the reader may well consider this review supplementary to Heimann's.

by the industries with the cooperation of the government, and calculated so as to achieve equilibrium at full employment. The increased output of, say, the automobile industry would require increased employment both in the industry itself and in the auxiliary industries, and the workers newly employed in the automobile works and steel factories would buy additional quantities of clothing, farm products, refrigerators, radios and all other consumer commodities, thus in turn increasing employment of workers in the textile industries, the household goods industries and so on. The magnified wages and profits would create the purchasing power essential for the new level of output in the automobile industry.

So far there is nothing new in Ezekiel's proposal. The contribution of his work lies in his method of achieving industrial expansion. While he is not lacking in the ardor of a reformer he is openminded enough to see that the industrial entrepreneurs are just as anxious to increase their output as the government is to see more workers employed. The reason why entrepreneurs do not expand production is that they shun the risk, and the risk is real because no one entrepreneur is sure that his actions will be accompanied by consonant action on the part of others. If the automobile industry expands production the clothing industry may fail to expand its operations and may, rather, satisfy the increased demand through sales from stock—not out of sheer malice, of course, but for lack of confidence in the permanence of the increased demand; and in this case the necessary demand for cars may not be forthcoming. Or the building industry may retrench while the automobile industry is expanding, and the decrease in the purchasing power of the discharged bricklayers and carpenters may offset the increased effective demand of the automobile workers.

If the individual entrepreneur could be given a guarantee that all entrepreneurs would act in conformity with one another, the incentive to expand would clearly exist. Ezekiel suggests that the government give the entrepreneurs such a guarantee: a government agency should make contracts with all major industries, obligating them to expand output according to the common plan, and assuring them that if any part of their additional product remains unsold the government will take it over. This would mean a risk for the government, but Ezekiel is right in suggesting that if the plan is carefully calculated the losses incurred by the government will be a small fraction of those it suffers from a depression, or the continuance of a depression.

Ezekiel is a man of action, not content with the intellectual satisfaction of having proposed an original idea. He is anxious to have his

program adopted. This may account for the great concessions which he makes to industrial self-government. His proposal that the individual industries, organized in a form very similar to that of the NRA codes, should work out the expansion program with the approval and the technical assistance of the government, instead of the government planning the program after consultation with the various industries, may be defensible on tactical grounds but is not compatible with the nature of the task. The problem is mainly one of interdependence of industries, and is therefore beyond the scope of a single industry. No real expansion plan will be achieved unless a central agency takes the leading role in its elaboration. Moreover, it is hard to see how monopolistic tendencies would be avoided if "industry authorities" were in a position to propose as well as administer the plan. Such delegation of authority to an industry would provide a very effective means of forcing each member-firm into a common front for "price maintenance." As the limits of existing plant capacity were reached, each industry would be interested in remaining behind the others in the expansion move, because this creates the most favorable relation between cost and receipts. Consequently the "industry authorities" cannot be expected to propose that amount of expansion for their own industry which would contribute most to the success of the plan.

Not only has Ezekiel neglected the monopoly problem, but he does not do complete justice to the price problem. No plan can be made without anticipation of prices by the central planning body, if for no other reason than that every plan presupposes an estimate of the future national income and its distribution. Without forming an opinion on how much will be earned and who will earn it, it is obviously impossible to make any estimate concerning demand for goods, and earnings cannot be estimated without assuming price relationships.

In the field of socialist price theory a very important step forward was made through the publication of articles by Oscar Lange which have since been reprinted, with some additions and changes, in the little volume edited by B. E. Lippincott and titled *On the Economic Theory of Socialism*. Lange's contribution to this booklet, which also contains an article by the late Fred M. Taylor, is essentially an answer to the new form of the anti-socialist and anti-planning argument, as brought forth by F. A. von Hayek and Lionel Robbins in the symposium, *Collectivist Economic Planning* (edited by Hayek, London 1935). These two authors concede that price calculation in a socialist society would not require a mathematically unfeasible procedure, but they maintain that no human brains could perform all the calculating

operations which would be necessary to establish the prices for a socialist accounting system. (Ludwig von Mises, who also participated in the symposium, has hardly modified his former fundamental objections, and he finds a supporter of his intransigent position in G. Halm.)

The discussion between Hayek, Robbins and Lange centers around the problem of price calculation in an economy in which all instruments of production are collectivized, but the issues are relevant also for an otherwise "capitalistic" society which is to be guided by central planning. Obviously, planning consists in devising for the managers of enterprises courses of action which these managers would not take if they followed the lead of prices emerging from an unguided capitalistic market. Otherwise there would be no point in even trying to plan. But, because of the complexity of economic life, courses of economic action cannot be devised except by price calculation; on this, it seems, there is now general agreement. The planning board must therefore establish prices independently of the capitalistic market price. These prices must correspond to the situations which the planning board is going to bring about through its own guidance of the market.

In other words, whether enterprise is private or collective, the instructions which the planning board gives to the managers of the individual plants must be expressed in terms of prices (although not necessarily in terms of prices alone), and consequently the planning board has not only to suggest or prescribe to the managers the physical volume of operation, but also to anticipate the prices which correspond to these contemplated changes in physical output. And the planning board needs a knowledge of prices not only for its instructions to the managers, but also for its own deliberations, since the economically desirable among the technically possible ways of increasing production cannot be selected without accounting operations. With the planning board, as with the capitalistic entrepreneur, technical and price considerations are closely interconnected.

How will the prices be determined? Lange's answer is: through a trial and error method, applied in cooperation by the planning board and the managers of the individual plants. He describes the procedure in the following terms: "Let the Central Planning Board start with a given set of prices chosen *at random*. All decisions of the managers of production . . . and also all decisions of individuals as consumers and suppliers of labor are made on the basis of these prices. As a result of these decisions the quantity demanded and supplied of each commodity is determined. If the quantity demanded of a commodity is not equal to the quantity supplied, the price of that commodity

has to be changed. It has to be raised if demand exceeds supply and lowered if the reverse is the case. Thus the Central Planning Board fixes a new set of prices which serves as a basis for new decisions, and which results in a new set of quantities demanded and supplied. Through this process of trial and error equilibrium prices are finally determined" (p. 86).

Thus according to Lange the planning board sets the prices and then watches the reaction of managers and consumers in expanding and contracting supply and demand. Such a procedure is perfectly feasible, and its effects would guide the planning board in currently checking the correctness of prices. This is undoubtedly an important function of the planning board. But the board must do more. It must anticipate future prices according to the future use of resources which it contemplates. Thus in devising long-range plans the planning board cannot wait for the presence of surplus stocks or unsatisfied demand to reveal the correct price.

A careful reader may find this implied in Lange's article, but there is no explicit treatment of the necessity of calculating the future prices essential for planning.² In my opinion the principle of trial and error, whose fundamental significance for a socialist economy Taylor and Lange have so brilliantly elucidated, is the intellectual tool with which this problem too may be solved. What can be tried out in reality, can also be tried out on paper, if reasonable assumptions can be made concerning the determinants. There is no reason why trial and error methods cannot be applied to the paper calculation of prices, understood as "terms on which alternatives are offered," under conditions which do not yet exist but are assumed to conform to a future reality. The specter of a planning commission becoming hopelessly involved in mathematical operations can, as Lange rightly believes, be dismissed by the realization that this commission has only to do what the individuals in any type of economic order are doing every day. The only important difference lies in the fact that the commission can do it in an incomparably shorter time and with incomparably lower cost, because in the phase of trial it is working on paper instead of with actual resources.

² Lange's failure to treat explicitly the problem of anticipated prices for advance planning may possibly be accounted for by his view of the causes of fluctuations within a capitalistic system. He is much more optimistic than this reviewer concerning the possibility of remedying the effects of depression by a complete calculation of *social* cost, including the cost of unemployment, as would be the duty of a socialist planning board. Therefore he may not consider anticipation of supply and demand an essential means of economic stabilization.

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Suppose that a practical attempt were made to carry out Ezekiel's ideas, as is provided for in two Congressional bills (the Keller Bill, H.R. 7480, and the Voorhies Bill, H.R. 7504)—would that effort lead to failure because of our lack of intellectual preparation, thus confirming Hayek's belief that "today we are not intellectually equipped to improve the working of our economic system by 'planning' " (p. 241)? More than likely the problem would be solved in the course of the practical attempt. The theoreticians have now carried analysis to the point where a large-scale experiment in statistical planning, with both physical and price figures, can contribute much more to progress than further endeavors of abstract reasoning, however interesting they may be in themselves.

The term planning is unfortunately applied to two entirely different policies: to the expansion of productive activities on the basis of a common plan; and to restrictive intervention by governments or monopolistic organizations. So long as this usage prevails one can hardly either support or oppose planning in general, although many authors speak as if the grounds on which one may reject international cartels were applicable also to the Russian Five-Year Plan, and vice versa. To an orthodox laissez faire economist the problem may present itself in the form of unrestricted competition against any form of interference, but such a degree of orthodoxy is rare now, and all the rest of us will have to make our evaluations dependent on the aims and possibly the technique of the proposed intervention.³

The failure to distinguish between expansive and restrictive planning is evident in the booklet of Bruck, a reprint of lectures on planning in Germany. Bruck is primarily concerned with the concept of restrictive planning, with the adaptation of supply in an individual industry to a demand presumed to be of a given magnitude. Since he pays little attention to expansive planning, which stresses coordination of all industries, he overlooks planning's greatest potentialities.

F. E. Lawley is an ardent supporter of planning who commits the same mistake as the more skeptical Bruck. But his book is extremely valuable as a source of material. Nowhere else can one find so complete a survey of policy concerning public ownership and the public control of industries throughout the world. The scope of the book is much wider than a mere recording of planning attempts, but the

³ The distinction between restrictive and expansive planning has been made with model clarity and in a very enlightening form by P. W. Martin in his two articles on "The Present Status of Economic Planning" in *International Labour Review* (May 1936 and February 1937).

latter material fills a considerable sector. The most serious weakness of the book is the author's unconditional and indiscriminating bias in favor of nearly every form of collective intervention. He pays little attention to the neo-mercantilistic character of many of the practices of government interference at the present time as long as they do not occur in the field of international commerce, and while he is not in favor of monopolies, he generally underrates the danger of monopolistic tendencies when discussing market regulation. This is evident in many parts of his first volume, and especially in the section which deals with national economic councils. These councils, which exist in various countries, are as a rule composed of representatives of the several branches of production, with an almost invariably ineffective consumer representation. Whatever the merits of these bodies as assemblies of technical experts who may pass on proposed economic legislation, as policy-making groups they are usually dominated by the sectionalism of individual industries, and they rarely give enough attention to the interdependence of all industries. As a consequence, they are inclined to fall back on restrictive price maintenance policies, and are unlikely to consider any proposals to widen the market by mutual expansion. It is therefore unfortunate that Lawley almost identifies the establishment of national economic councils with the movement for planning.

Generally speaking, Lawley does not carry the analysis of the topic and of the material far enough. He has, for instance, collected an abundance of facts concerning credit regulation by central banks, but he does not stress the fundamental importance of this matter for the "growth of collective economy" in general, or for economic planning in particular. Similarly, he has not realized that arbitration of labor disputes, because it implies determination of wages, is one of the most significant forms of government interference, and in this case has even failed to collect the relevant material.

The book by Franz Eulenburg, *Allgemeine Volkswirtschaftspolitik*, contains a section on economic planning with many interesting ideas. He recognizes that the public budget is a planned sector of growing importance within the market economy, and that the compilation and administration of the budget offer an object lesson for studying some of the characteristics of economic planning. There are not only points of comparison, however, but also great differences between the position of a treasury which plans and executes a fiscal budget and that of a planning board which guides production. Only to a very limited extent can the treasury anticipate the conditions on which the correct-

ness of its estimates depends. A change from prosperity to depression or vice versa usually means that the estimates of public expenditure and revenues will be wrong, yet the treasury of a "free enterprise" economy has no reliable barometer which would enable it to forecast economic storm or sunshine. Moreover, it has no decisive influence on the determinants of the economic weather. A technical and economic plan for a whole nation, on the other hand, is not dependent on any uncalculable outside conditions which would be subject to sudden change, aside from climatic influences on agriculture and, to a far lesser extent, fluctuations of consumers' tastes.⁴

Eulenburg overlooks this difference and its implications. The rigidities of budget procedure are not due principally to the bureaucratic character of public administration, which might be expected to express itself in planning as in any other government activity, but are due rather to the necessity of maintaining, so far as feasible, the stability of the budget in an unstable economy. The budget must be executed as planned even when conditions change (within wide limits), and this is tantamount to saying that the fiscal authorities must refuse to take changes into consideration until they become too great to be ignored. The element of immobility in the rules and practices of the fiscal authorities is not a weakness but a virtue, made necessary by the artificial and almost fictitious conditions under which these authorities have to work in an unguided economy. There is no good reason to assume that a planning board would show the same immobility.

Balancing the Economic Controls, by Stevenson and Vaile, is one of the best studies available in regional planning. Although it was published several years ago the methods and proposals suggested have not lost interest. The authors, who are teaching at the University of Minnesota, have analyzed the business structure of their state with great ability and thoroughness, and have also described the policies suggested during the depression period by the Employment Stabilization Research Institute, of which Stevenson is Dean. The most interesting of these remedies were the "banking clinic" and the "industrial clinic." These were the advisory services available to industrial or

⁴ The Swedish experiment of using public finance as a method of business cycle policy has so far proved only that a policy of deficit spending, if planned with circumspection and executed in favorable circumstances, has a fair chance of mitigating depression, accelerating recovery and eventually liquidating itself. It has not proved that public finance, by using restrictive measures when a boom is imminent and expansive measures when economic activity begins to slacken down, can eliminate economic fluctuations.

banking managers who felt that the operations of their concerns needed improvement. At the time of the publication of the book these services had not developed beyond elaboration and application of certain standards for the individual business. If such a "clinic" grows into more than a mere emergency institution it will have to take into account, however, the interdependence of various branches of business. It must give the entrepreneur not only advice on the most efficient use of knowledge which he possesses, but also information on presumable developments which he, as an individual firm owner, could not know. In this way regional planning could make a great contribution to the development of planning methods which would eventually be applicable on a national scale.

Regional planning is the subject matter of a considerable part of the symposium edited by Findlay Mackenzie. It was an especially good idea to include in the volume the report of the Great Plains Drought Area Committee, since a study of the problem of soil conservation shows very clearly not only the potentialities but also the limitations of regional or any other form of partial planning. It is clearly impossible to reform the methods of agricultural production until we know what we should produce in the long run, and to know this is impossible without a plan for the whole national economy.

There are other interesting contributions in this volume, such as the very useful survey by W. H. Steiner of theories and practices of credit control. In addition to this and similar surveys, the volume contains reprints of important articles in which the leaders of different schools have expressed their opinions on planning. The book is very useful for purposes of academic instruction.

Some authors have developed a great interest in the planning of international economic relations. In this field the prejudice against state intervention has weaker roots than in domestic policies, since protection by tariffs and similar artificial barriers has been a familiar practice. But many of the contemporary enthusiasts for international economic planning are opposed to protectionism, though they are not always successful in eliminating protectionist elements from their proposals. The reason why they desire to substitute regulatory policies for *laissez faire* in international relations is that they believe this course to be a logical consequence and a necessary complement of their demand for national planning.

Such an inference, however, need not be drawn. The wholesome consequences which the classical economists expected from the unrestricted operation of business enterprise depend on certain basic pre-

suppositions. The unreality of these assumptions when applied to the domestic scene does not necessarily imply a like unreality in the case of international exchange relations. It may quite logically be argued that the need for regulation is absent in international relations but is essential for the domestic economy. Nor is there an absolute practical necessity to supplement national by international planning. It is true that domestic planning will in many ways affect the international exchange of commodities, and that no national plan will be complete unless it provides for definite amounts of imports and exports. Therefore planning presupposes control of foreign trade. But this does not necessarily imply the need for an international planning agency, or the use of any new instrumentalities for directing the flow of commodities between nations. Of all areas of economic life none is more easily surveyable, or can be more effectively controlled by methods already in use, than international commerce. It is therefore imaginable that representatives of governments which are engaged in the execution of production plans in their respective countries will negotiate reciprocal trade agreements in a fashion similar to that of today.

F. E. Lawley, who in his second volume deals with international relations, is one of those authors who advocate international planning as a part of their opposition to *laissez faire*. "What is required is international collective intervention to ensure that the dominant force in international economic life is no longer the quest for private and national profit" (pp. 4, 5). "*Laissez faire* implies economic anarchy. It has meant that the capitalists of the various countries have invested capital and produced and distributed commodities just as they have felt inclined, in the natural pursuit of their profit and individual interests, with no relation to or knowledge of the real needs and economic conditions of the peoples of other countries, and with no power to control the resultant, inevitable fluctuations in economic life" (p. 361).

Lawley does not explain how businessmen could make profits if their decisions had no relation to the real needs and conditions of the people for whom they produce, and makes no effort to prove that the inevitable fluctuations in economic life have any important root in the *international* transfer of commodities or money capital (which, as far as this reviewer's knowledge goes, is about the only imaginable business cycle theory which has never been seriously proposed). He severely criticizes the League of Nations and other international agencies for their "unreadiness to jettison the ideas of *laissez faire* and free trade," and proceeds to the conclusion that a World Economic Coun-

cil must be established and elect an executive, and that among the responsibilities of these two bodies should be "the choice of the places at which production of the most important raw materials and manufactured goods should occur," "the fixing of production and transportation costs" and "the provision for the collective accumulation of capital" (p. 401). Even if the nations were prepared to cede so great a part of their sovereignty to an international organization, it would not be a blessing for mankind. Such an international government would necessarily be sheer absolutism, because nations with entirely different political institutions and philosophies cannot effectively control a common government. Nations must grow into an international society before democratic international government becomes possible.

With all its weaknesses Lawley's second volume is, like the first, a most valuable collection of facts. The reader is provided with an abundance of material on the economic activities of the League, on the deliberations and achievements of the International Labor Organization and the Bank for International Settlements, on production and exchange of commodities and on international economic agreements, both between governments and between private groups. If considered, however, as an attempt at analysis and not merely as a presentation of source material, the second volume suffers like the first from the author's failure to dig deep enough. Even the collection of material has been adversely affected by the fact that some fundamentally important problems have remained outside of Lawley's scope. For instance, while the reader is told of the efforts of the southeastern European countries to find markets for their agricultural products through combined action, he does not learn that there is a great competition between these countries and overseas nations such as Canada, Australia and Argentina for the markets of European consumer countries, and that this rivalry is one of the great conflicts of interest in international economics. No effort is made to show why, at the World Economic Conference of 1927, international cartel agreements were the main counterproposals which the French made to the German insistence on low tariffs and an unconditional most-favored-nation clause. (Incidentally, the 1927 conference was not so entirely unsuccessful as Lawley assumes, since the German-French Trade Agreement of 1927 and a series of subsequent trade agreements were its indirect results.) The dangers of an economic isolation of Europe from Asia and America are passed over with an entirely unwarranted lightheartedness (p. 418). Yet these are the very problems with which an international economic government, either for the world as a whole or for

Europe, would have to cope, and the difficulties of establishing and operating such a government cannot be estimated unless such problems are fully understood. There is no doubt that some day we shall have international economic planning undertaken by a world agency, but the probability is that this will succeed and not precede collective planning on a national scale.

The book by G. D. H. Cole is devoted to the whole planning problem, but its most original and valuable sections deal with the international aspects. These sections are as much worth reading today as in 1935 when the book appeared. Cole is less interested in what an international economic council would do than in the effects of domestic planning upon the international exchange of goods. In a planned economy regulation will never have the aim of diminishing imports, but merely of eliminating disturbing fluctuations. The nation "will want to import as much as its exports and other means of payment abroad will allow it to purchase" (p. 212), because it wants to provide a maximum of commodities for consumption. At the present time nations are not only committing the mistake of forcing down their imports, but at the same time are trying to increase their exports, which is an obvious contradiction. ". . . the essence of an unplanned economy is that it does conceal the impossibility of having things both ways. Planned economies, on the other hand, have to decide their policies with their eyes open; and there is no possibility for them of closing their eyes to the inconsistency of aim which is a common feature of the commercial policies of today" (p. 311). Cole's statement can be generalized: economic planning is an effort not only to extend but to coordinate government policies, to eliminate the contradictions of neo-mercantilism.

Can this goal be attained while important instruments of production are privately owned? Mrs. Zahn-Golodetz' study makes a case for a negative answer to this question by comparing the American New Deal with the planned economy of the Soviets. The booklet is ably written and a great help to one who wishes a brief orientation on the development of economic policies in Soviet Russia. But while Mrs. Zahn-Golodetz tells the reader a number of things worth knowing, she fails to prove her proposition. In fact, this proposition cannot be sustained or even convincingly examined by the merely empirical methods which she uses. It is easy to show that the American New Deal is self-contradictory in many of its parts, but why does this prove that every conceivable form of *économie dirigée* (planned economy based on private property) is self-contradictory? The mere fact that the New

Deal has up to now been the most important attempt to establish an *économie dirigée* does not warrant a generalization. The author seems to forget that quite a few of the objections which she raises against *économie dirigée* could have been raised against the Soviet economy before the First Five-Year Plan. If we wish to know whether industry must be socialized before a total national plan can be established, the only way is to find out through an essentially deductive analysis what the presuppositions of total planning are and whether collective ownership of the instruments of production is among them.

The logical and factual relation of collectivization to planning has been badly neglected in recent years. There was a time when this problem was intensely treated, especially in German literature, but there is little in these earlier discussions which can be applied to present conditions. (The writer does not find it possible to maintain all the observations he made on this subject prior to 1934.) It is still true that the success of planning may be endangered by private ownership of industries, but if good use is made of the lessons suggested by the fate of the New Deal and other attempts, those dangers can be greatly reduced. Moreover, to approach planning via collectivization of industries would now mean the choice of a very long roundabout way, while in the early 1930's this route seemed to be tolerably short. Countries such as Germany and Austria, in which the movement for socialization has always been strong, are no longer connected with the world economy, and the likelihood is that they will not for a long time be centers from which economic reorganization could start.

The forces which now promote the movement for planning originate far more from an interest in economic stabilization than from an interest in collectivization of industries. To carry out social innovations it is necessary to use the available forces. Ultimately national economic planning will in all likelihood result in collectivization of Big Business, because the function of the Great Enterpriser, to open up new avenues of economic endeavor, will eventually have been transferred to organized society through the institution of planning, and a group which has lost its social function will not in the long run be able to maintain its position of power. But the final incompatibility of planning and large-scale private enterprise does not imply a definite time sequence of social changes, and those among us who were formerly convinced that collectivization must precede planning have good reasons to reopen the case.

CARL LANDAUER

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BOOK REVIEWS

NUSSBAUM, ARTHUR. *Money in the Law*. Chicago: Foundation Press. 1939. 534 pp. \$7.50.

Professor Nussbaum's *magnum opus* is the product of fifteen years' labor directly, and of a lifetime of specialization upon this phase of jurisprudence. The author explains that this book is "written primarily for lawyers, practitioners as well as students." And though "it makes no pretense to discuss the purely economic aspects of money" the author's belief is amply warranted that the study "may prove to have pertinence for many questions with which economists are concerned."

Economists will find the first three chapters on basic monetary concepts, kinds of money and monetary systems most germane to their subject matter, though the second half of the book, devoted to debts, has many very significant parts. With regard to the nature of money, Nussbaum takes a nominalist position which the reviewer has for some time regarded as the best theory. The term "money" is made to refer to material media of exchange which are treated by the market as some fixed fraction, multiple or equivalent of the unit of account (pp. 3, 5, 7, 16). The theory is "societary" in recognizing the market or trade usage as the ultimate arbiter as to what circulates and at what value; the role of the state is very important, but not supreme (p. 135). In one respect Nussbaum departs from the general nominalist position and from the almost universal practice of economists nowadays, in refusing to include deposit currency as money (p. 103). The ground that the velocities of deposits and cash differ is not sufficient, for the velocities of money in the cash balances of various segments of the economy also differ; and it is not necessary to "abandon the corporeal notion of money" in order to include deposit currency under money, inasmuch as the entries in bank accounts are anything but pure abstractions. In other respects Nussbaum consistently maintains the nominalist doctrine: outside the country money is a commodity (p. 113); new currency systems require a reference link of the new to the old monetary unit (p. 148); debts are essentially defined in monetary units (p. 249).

It is quite impossible within the brief confines of this notice to indicate the great erudition, exhaustiveness and scholarship of Nussbaum's work. Each section indicates something of the historical derivation of the law, its most important interpretations in recent history, significant cases in western Europe and the United States, and the reasonableness and consistency of various statutes, decisions and ad-

ministrative rulings; and the range of subjects is encyclopaedic. One is driven to the expedient of mentioning a few subjects which strike especially upon one's own attention.

The student of economic and monetary history will read with especial interest the account of the "Portuguese Bank Note Case" (pp. 93-99), and the entire section on the American monetary system (pp. 162-211), embracing a legal history of the dollar, an analysis of our present monetary structure from the legal angle, and its constitutional aspects, including the Civil War legal tender acts and cases. Sections on usury and the American maximum-interest acts, though condensed, convey the impression of masterly survey (pp. 237-48). American students can learn from Nussbaum's account (pp. 269-96) everything of importance concerning the German revaluation experience following the 1914-23 depreciation of the mark. The sincere student of monetary problems will not miss his explanation of the absence of gold clauses in contracts in England, their ubiquity in the United States before 1933 and their peculiar status in France (pp. 300-10, 334-56). Finally, from among other timely subjects may be mentioned the concluding chapter devoted to "Debts under Exchange Control."

While Nussbaum's work will probably find its chief employment among economists as a reference book, a reading of the entire volume will supply a wealth of historical and institutional background material on monetary problems in general.

HOWARD S. ELLIS

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BONBRIGHT, JAMES C. *The Valuation of Property: A Treatise on the Appraisal of Property for Different Legal Purposes*. New York: McGraw-Hill. 1937. 2 vols., 1271 pp. \$12.

Among the scanty writings in this field this monumental work stands out like a green forest in the midst of stretches of unbroken prairie sod. It stands out in many ways, but mainly in its great wealth of original thought, its analytical scrutiny of the right objects, and its familiarity with the often awkward purposes of, and the thousand-and-one occasions for, particular valuations.

Bonbright surveys the usual terminology of courts, banks, purchasers, sellers, tax assessors, appraisers. He discards a good deal of it as verbalism and rearranges what is left for careful consideration. He adopts the functional approach, and shows that for purposes of appraisal the term "value" has many meanings. Bonbright recognizes the validity of and justifications for distinctly different concepts of what

a piece of property is worth to a specific group or person, for a specific purpose, under specific conditions of sale or under various assumptions of wealth, income, investment and operating capital, for specific periods, present, past or future.

The book briefly limits its discussion of economic theory of value to the subject of estimating specific amounts of value, but it recognizes how little economic theory has ever sought to give assistance or guidance to those who have to face the task of making the estimates.

Various methods of estimating value—such as using sales prices, actual or original or replacement costs, depreciating prices or costs, and capitalization of various sorts of income—are discussed in principle and from the point of view of methodology. Later they reappear in various chapters dealing with the problems of valuation for specific legal purposes, such as fixing indemnity under insurance, or determining liability or expropriation payments under eminent domain, or assessing for tax purposes. The second volume deals in great detail with valuations and the unit rule as set by the courts under estate and inheritance taxation, with mortgage foreclosures, and with special problems of valuation for corporations. A final chapter deals with valuation for the sake of determining income.

The meticulous documentation of the work and the vast number of citations of cases and legal precedents, as well as the subtle and leisurely discussion—frequently delightfully informal—give the book the quality of a *magnum opus*. It reflects the wisdom of a scholar of amazingly broad experience in the field of valuation, who is also an authority on the intricate subject of public utilities and finance.

Along with Babcock's excellent volume on the valuation of real estate, Bonbright's book belongs in the fundamental stock of any library on valuation and appraisal. In the three years since its appearance it has gained an international reputation as the best standard work, and it already ranks rightly as a classic.

KARL BRANDT

Stanford University

LOVEDAY, A., CONDLIFFE, J. B., OHLIN, B., HECKSCHER, E. F., DE MADARIAGA, S., ROBERTSON, D. H. *The World's Economic Future*. [Sir Halley Stewart Lectures, 1937.] London: Allen and Unwin. 1938. 134 pp. 4/6.

This series of lectures by a number of well known economists from Great Britain and Sweden, given about two years before the great cataclysm, has now to be reviewed by a critic armed with all the over-

whelming wisdom of "hindsight." To read this book is an easy way to reach a clear idea of how fundamentally things economic have already changed, after scarcely more than one year of large-scale warfare of modern size, cunning and cruelty. The sheer size of consumption of goods for the formerly unusual purpose of pursuing warfare, and of the resultant investment in industries catering to this new kind of consumption, has thrown out of gear many conditions of the problem as these men saw it in 1937.

It is not so much the individual fault of the authors that they did not foresee this radical change in the economic conditions of national life in the democratic countries and the new upsurge of imperialism. "Silent arma inter leges" was the dangerous optimism that had taken the place of the old proverb, borne out by centuries of bitter experience: "Silent leges inter arma." With the facts under their noses and with the constant reiteration of the dictatorial promises, as handed out to every bride and bridegroom on their wedding day, the democratic optimists saw the giraffe and just could not believe it. To what an extent economic and political science took part in this orgy of lethal optimism is shown here by a remarkable specimen. It would be quite unjust, however, to single out the authors of this volume as being particularly worse than others. European democrats were not more weakminded than democrats elsewhere, and their economists had hardly any forebodings of the wrath to come. "An illusion of spiteful, jittery refugees, queerly enough fostered by otherwise reasonable Dorothy Thompson" was the underlying feeling against warnings on both sides of the Atlantic. Thus this book represents a species, not a document of its authors' particular lack of foresight.—So the critic, unsportingly privileged by the advantages of looking backward over more than a year of war.

To give the book the respect owed it, with these reservations—if the reader wishes to find a spirited, well presented example of the prewar outlook, moderate and, in its way, at the same time courageous, he will find it here. I particularly commend Loveday's thoughtful analysis of the causes for the changes in demand for more durable goods in recent times, and of the consequences on economic life as a whole. Other passages, especially in Ohlin's lecture, deserve similar praise. In fact, I hope that the book will be read widely—in its right setting, as a document of applied economic science at its best and at its worst, interesting on every page and a warning to us all.

HERMAN KRANOLD

Talladega College

RAPPARD, WILLIAM E. *The Crisis of Democracy*. [Lectures of the Harris Foundation 1938.] Chicago: University of Chicago Press. 1938. 288 pp. \$2.50.

Rappard's book is a sober discussion of the political and economic reasons which account for the downfall of the democratic system in the world today. After tracing the rise of democracy in Europe from the days of ancient Athens down to recent times—it should be noted that the distinguished Swiss author considers Swiss democracy to be a product of a general trend in European politics rather than the cradle of modern democracy—Rappard gives a vivid, well documented account of the ill-fated success of democratic ideals at the end of the World War and the subsequent retreat of popular government.

It is true that in an historical perspective the World War—by making for concentration of power in the hands of the executive and enlargement of the sphere of the state—seems to have instituted the eclipse of democratic liberty rather than to have unleashed truly democratic forces; the political implications of modern warfare are

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not to be denied. Nor can Rappard's other view be refuted that the specific methods of modern social policy partly account for the totalitarian trend of today. But the importance which Rappard attributes to these factors in explaining the crisis of liberal democracy is out of proportion to their real weight. He neglects to search for the deeper-lying spiritual forces which are at the root of present-day totalitarianism. Thus he can afford an optimism as to the future of democracy which such an analysis would prove unwarranted.

Although Rappard is not too favorably disposed toward state intervention in economic matters he does not commit the usual mistake of indiscriminately condemning it. He recognizes that no industrial community in our day can claim the same measure and the same kind of freedom from state control and state supervision as our forefathers enjoyed at the beginning of the nineteenth century. But he emphasizes that the goal of any interventionist measure should be to secure conditions most propitious to self-reliance and liberty.

ERICH HULA

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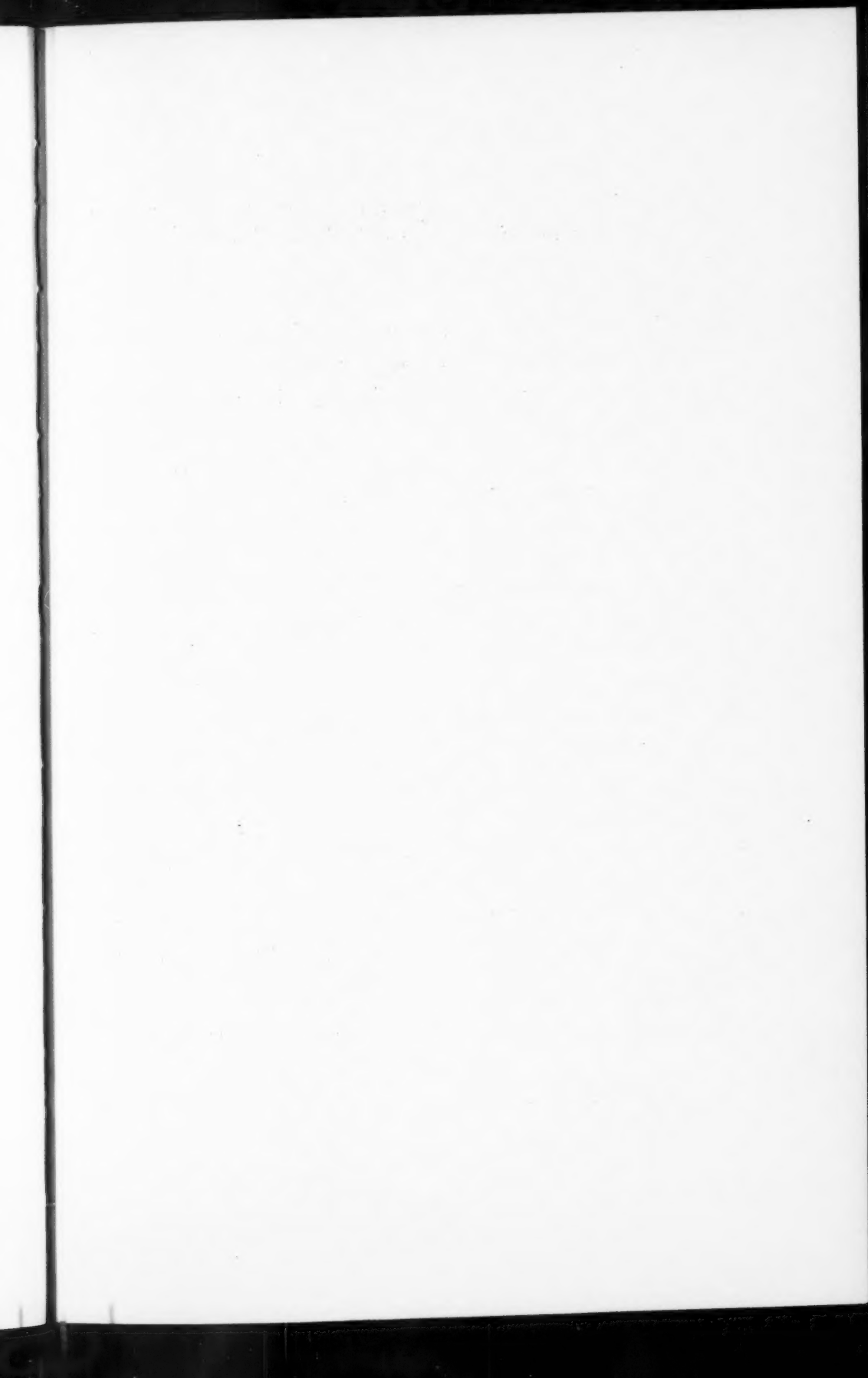
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